# *Export strategy and pricing policies in medium-sized manufacturing firms in the north of England with particular reference to the effect of sterling floatation*

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## ABSTRACT

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EXPORT STRATEGY AND PRICING POLICIES IN MEDIUM-SIZED MANUFACTURING FIRMS IN THE NORTH OF ENGLAND, WITH PARTICULAR REFERENCE TO THE EFFECT OF STERLING FLOATATION

The objectives of this study are to contribute to the understanding of the export process in smaller firms and to provide a benchmark against which export strategy and pricing policies can be assessed, particularly in the context of the impact of floating currencies on exporters.

The study consists, firstly, of a literature survey in the fields of pricing and export management, drawing on some 600 sources. Primary data were collected through a small number of depth interviews with export executives and a postal questionnaire survey of 250 medium-sized exporting manufacturers in the North of England, drawn from the Clothing, Furniture, Chemicals and Scientific Instrumentation industries.

The theory of export strategy is reviewed, particularly in the context of key market concentration, as the foundation for export policies, including export pricing on which attention is focussed here. Challenges are offered to the arguments and empirical evidence on which the key market philosophy is founded and an alternative strategy proposed: market spreading. Empirical evidence is produced to show the existence of both concentration and spreading strategies in practical exporting, and to assess the underlying logic of market spreading as an alternative to market concentration, together with the situational cues associated with each.

From general pricing theory and methods, attention is directed to the more specialised problems of export pricing.

Consideration is given to the relationship between domestic market and export prices and pricing methods, and the existence and form of discriminatory pricing in exporting.

The emphasis placed on price in the export marketing programme is analysed in the context of the debate on price versus non-price aspects of competition in international markets.

Lastly, arising out of export pricing policy is the key issue of pricing currency, particularly as the mediator of the impact of floatation on the exporter. Attention is given to the export invoice currency decision, and the underlying reasons for currency choices as a challenge to the normative theory offered to exporters by the literature, together with the consequent implications of currency movements at the company level.

# EXPORT STRATEGY AND PRICING POLICIES IN MEDIUM-SIZED MANUFACTURING FIRMS IN THE NORTH OF ENGLAND, WITH PARTICULAR REFERENCE TO THE EFFECT OF STERLING FLOATATION

VOLUME 1

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# TABLES AND ILLUSTRATIONS

## DECLARATION

No material in this thesis has previously been submitted for a degree at this or any other university.

The thesis is based wholly on individual research conducted by the author.



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# SUMMARY AND OVERVIEW

This study consists of a large literature review in the frequently disparate fields of pricing theory and export management, followed by the collection of a considerable volume of empirical data generated to fulfil a number of research objectives developed from the literature. The resulting volume of information justifies this early summary and guide to the substance of the paper.

This short review of the study considers firstly, the objectives and methodology adopted, secondly, the elements of the literature survey completed, and thirdly, a guide to the empirical findings with references to the relevant parts of the thesis.

## 1. Objectives and Structure of the Study

The objectives of the study are outlined in Chapter 1, pages 22-23, and are concerned with providing a greater insight into the export process in smaller firms, to add to the theoretical understanding of export management and to provide practical, comparative data for exporters.

The methodology involves both secondary and primary elements, based in the first case on the literature of pricing and export management, and in the second case on an empirical study using a postal questionnaire, of medium-sized companies exporting from the North of England.

## 2. The Literature Survey

Chapter 2 reviews the theories and management problems of pricing, on pages 25-68.

This review is itself extensive, as a result of the need to recognise the multi-disciplinary approaches to pricing which are available.

These approaches go beyond the offerings of neo-classical economic theory and its more recent developments and challenges.

Chapter 2 is structured into a review of theories and models drawn from economics, finance and accounting, the behavioural sciences, marketing theory, management theories and empirical evidence of practices.

Economic theories offer initially the classic supply and demand model of price determination, with its generalised finding that prices are determined by, and change in response to, demand. This model has been attacked through the normal cost argument of price determination, the concept of administered prices and criticisms of the underlying assumptions of the economic model regarding marginalism, information freely available, adjustment costs, buyer rationality and product substitutability. Lastly, attention was given to the theories of price determination developed to cope with imperfect markets, highlighting the impact of competitive interdependence and price rigidity.

The importance of these theories is in providing the conceptual framework and assumptions which are frequently applied to export pricing, explicitly or implicity, and the impact of floatation on export business.

The contribution of financial and accounting theories lies in the provision of operational measurement techniques and different cost concepts. The shortcomings of absorption costing are analysed, followed by the marginal and incremental costing arguments proposed by many theorists, and an attempted integration of the cues to the relevant cost concept in a given market situation.

The importance of this area is in providing the techniques and measurements used operationally, either in both export and domestic pricing, or possibly differentiating the approaches relevant to either.

The behavioural sciences offer an analysis of the perception of, and reaction to, price cues at the buyer level, in the household or the organisation. It is shown that there is a danger of exaggerating price awareness among buyers, which may differ substantially between situations, as may the consequent sensitivity of buyers to price. The major contribution here is in the interpretation of price as a cue, particularly in the context of indicating product quality. In the most recent work this view is developed with price as an informational cue interacting with others, which is later used to assess the problems facing the exporter.

The significance of this analysis is in suggesting the shortcomings of the simple assumptions made about the role and effectiveness of price competition, both generally and in exporting.

Marketing theories of price are concerned primarily with the relationship between price and the other aspects of the marketing mix, the dangers inherent in excessive promotional pricing and the changing role of price through the product life cycle.

The importance of these concepts is in reinforcing the point that price is one cue among many, and may not be the most effective competitive base, in the domestic or export markets.

Managerial theories of the firm view price as an administered variable resulting from the pursuit of objectives far removed from the simple profit maximisation of the economic model. This introduces the concept of satisficing which provides the context for pricing decisions of corporate objectives.

This leads to the identification of the types of management pricing decision faced in the domestic and export markets and the practical constraints facing management.

This part of the literature review is a preparation for the more specialised interest, in this study, of the export pricing problem and its structure.

Chapter 3, pages 69-174, gives a survey of the theories and empirical findings available in the field of export management, and particularly export pricing.

The review starts by analysing the motivations and company objectives associated with exporting and the empirical evidence relating to the internationalisation of the firm, with varying management attitudes and approaches to export marketing.

This is followed by a consideration of the elements of export strategy, particularly the issue of export market numbers. This issue is seen as the foundation upon which the other export policies are based, on the grounds that the practical feasibility of policies like product and packaging adaptation, price discrimination and local currency invoicing by market, and specialised marketing communications and distribution by market, depends on the export volume by market and the number of export markets to which the firm sells.

A challenge is made here to the widely accepted view that exporters should adopt a key market concentration strategy, since while it is possible to define situational variables favouring the key market approach, it is possible to do the same for the alternative of selling to a large number of markets: a market spreading strategy.

Closely related to this issue is that of export market selection and the availability of information to make rational market choices.

One of the most important aspects of the market concentration argument is the case for competing on non-price marketing variables rather than relying on price competition.

This leads to an assessment of the sources of international competitiveness and the observable and measured differences between the pricing policies pursued by exporters of different nationalities, and most particularly the differences between the pricing policies of UK exporters and those of the outstandingly successful exporting nations like West Germany and Japan.

In pursuit of the theme of pricing as an element of export strategy, the literature introduces at this point some of the aspects of export finance necessary to the development of the export pricing issue.

This involves a brief study of contractual terms in exporting and the impact of currency exchange rates together with the forward buying and selling of foreign currencies.

The last element of the literature survey centres on the export price problem itself and isolates the elements of the problem associated with the relationship between UK and export price levels, the export pricing methods used, and the impact of devaluation and floatation on export pricing, particularly with regard to the choice of invoice currency as a determinant of this impact.

## 3. Primary Research Objectives

In the body of the literature survey, and summarised at the beginning of Chapter 4 (page 9), a number of research objectives are established for the primary work.

These objectives are:

(1) To compare the objectives pursued by management in export and domestic markets.

(2) To measure the number of markets served by exporters and to isolate the factors contributing to the decision to pursue market spreading rather than the widely prescribed market concentration.

(3) To examine the establishment of export price levels for different markets.

(4) To examine the methods of pricing used for exports.

(5) To assess the determinants of export invoice currency choice and its effect on export price levels.

(6) To analyse the relationship between local market currency strength and exporter discretion in invoice currency choice.

These objectives for the primary research were associated with some 46 separate hypotheses, which were formulated for testing in the traditional manner.

The hypotheses are summarised at the beginning of Chapter 4 (page 9 ), and are tested against the empirical findings in the body of Chapter 5.

## 4. The Primary Research

The structure of the primary elements of the work is described in detail in Chapter 4 (pages12-16), and the results are shown in Chapter 5 (pages 17-242).

This work involved firstly, six depth interviews with senior executives in medium-sized exporting companies situated in the North-East of England.

These interviews were structured around a questionnaire, which is shown in Appendix VI (page 250) and the results are summarised in Chapter 5 (pages 16-24 ). The detailed responses are shown in Appendix VII (pages 256-263).

The depth interviews enabled the research objectives to be refined and a postal questionnaire produced.

The major data collection exercise was a postal questionnaire survey.

The sampling frame for this survey was defined as all firms meeting the following criteria:

<u>Medium-sized</u> - with 100 to 2,000 employees,
<u>Exporters</u> - selling to independent distributors or users in overseas markets,
<u>Manufacturers</u> - excluding service firms and distributors,
<u>in the North of England</u> - with a major operating unit in a region defined by the combination of the Standard Regions: Northern, Yorkshire and Humberside, and North-West,

in a chosen industry - part of the Clothing, Furniture, Chemicals or Scientific Instrumentation industries, as they are defined in the Kompass directory classification.

Sample selection involved a census of the 500 firms meeting these criteria. Sampling units were executives in charge of export, marketing or sales, or the Chief Executives.

The first draft postal questionnaire was piloted, minor revisions made, and the main postal survey was carried out in December 1979 and January 1980, with one reminder. The total useable response rate was 48%. Details of the analysis of response rates and timing are shown in Appendix X (pages 276-279) and the postal questionnaire is shown in Appendix IX (page 269).

The survey returns were coded manually, following a content analysis of the two open-ended questions and analysed using the Statistical Package for the Social Sciences in the Northern Universities Multiple Access Computer system.

## 5. Results and Conclusions

The results of the postal questinnaire may be discussed in general terms, together with the conclusions of the study, which are developed in full in Chapter 6 (pages 190-242).

Broadly, these are divided into the following areas.

### (1) Export Objectives and Internationalisation

The concept that there may be different degrees and types of development of the export and international function is pursued from the literature and used in the empirical findings to distinguish between the types of exporting and policies adopted.

Specifically, a relationship is sought between the internationalisation of the firm and the characteristics of the firm, as determinants of export strategy, pricing policies and methods and the invoice currency strategy pursued.

Closely related to this area is that of the marketing objectives pursued in exporting, particularly where these may differ from domestic market aims.

In this case too, a relationship is sought between the export objectives pursued, the characteristics of the firm, and export strategy, pricing methods and pricing strategy.

These results are presented in Chapter 5 (pages 30-42 ) and conclusions are drawn in Chapter 6 (pages 192-198).

(2) Export Market Number Strategy

The number of country-markets to which firms export is measured and compared to the findings of various earlier studies by different research groups. The results are given in Chapter 5 , in detail, and conclusions are drawn in Chapter 6.

The market strategy and the key market philosophy is analysed in two ways: firstly, in terms of the degree to which firms actually limit the number of export markets they serve, and secondly, in terms of the selective application of management and marketing efforts. This approach leads to the operational definition and identification of market concentration and market spreading as alternative export strategies.

Once this new classification device has been introduced, attempts are made to associate concentration and spreading strategies with different objectives, different levels of marketing information availability, alternative approaches to price setting and discrimination, the emphasis placed on price competition and the type of internationalisation in the firm.

The empirical results are reported in Chapter 5 (pages 43-79 ) and conclusions discussed in Chapter 6 (pages 199-206).

In the development of a logical basis for market spreading, the reasons for exporters dealing with large market numbers are analysed in Chapter 5 (pages 63-79 ) and discussed in Chapter 6 (pages 205-206).

(3) Export Marketing Information

The assumed availability of information to support export decisions is challenged by examining the sources of marketing information used by export executives.

This is assessed through both the number of information sources used and the types, and this is related to the export strategy adopted and pricing policies pursued.

The survey results are given in Chapter 5 (pages 80-88 ) and the conclusions in Chapter 6 (pages 207-209).

(4) Pricing in Export Marketing Strategy

The role and importance of price in the export marketing mix is assessed both in absolute terms and particularly in comparison with the domestic marketing mix.

The well-tried route is pursued not merely by way of replication but to attempt to distinguish between firms in terms of their views of price and non-price competition.

A relationship is then sought between the emphasis on price competition and other policies including export strategy, pricing methods, the degree of price discrimination and the export pricing currency decision.

The empirical findings are in Chapter 5 (pages 89-95 ) and conclusions in Chapter 6 (pages 210-211).

(5) Export Price Levels and Discrimination

Attempts are made to assess the relationship in exporting companies between UK and export prices, in terms of the establishment of a price base, and the degree and type of discimination in export prices.

These policies are then related to broader issues like export strategy, the emphasis on price competition and the availability of marketing information.

The survey data are tested in Chapter 5 (pages 96-112 ) and conclusions presented in Chapter 6 (pages 212-214).

## (6) Export Pricing Methods

Export pricing methods are assessed as a specialised aspect of the more general view of pricing taken in Chapter 2.

Contrasts can be made between domestic market and export pricing methods, and then the adoption of different approaches to export price may be related to other aspects of export marketing policy.

In particular, there is some interest in the export pricing methods used by firms with different internationalisation characteristics and pursuing different export strategies. Further, export pricing methods may be compared to the marketing objectives pursued in exporting and the type of competition emphasised.

The empirical results are given in Chapter 5 (pages 113-130) and discussed in Chapter 6 ( pages 215-218).

## (7) Export Invoicing Currency

Lastly, a specialised aspect of the export price policy pursued within export strategy is the decision on the currency in which exports should be quoted, priced, invoiced and paid.

The research firstly, assesses the use of different currencies by exporters and attempts to relate currency policies to factors like the internationalisation of the firm and export strategy.

Secondly, the reasons for currency policies are analysed in terms of the inter-play of internal organisational factors and forces from the marketplace of various kinds, and the possibility of using export price currency as a marketing or financial weapon in exporting.

The findings are shown in detail in Chapter 5 (pages 131-171) and conclusions in Chapter 6 (pages 219-224).

## (8) Export Prices and Currency Movements

Since export pricing and strategy operate in an environment of floating currencies, the study considers the short-term reaction of exporters to movements in Sterling against local currencies in different export markets.

It is necessary here to distinguish between firms invoicing in Sterling and those using foreign currencies, and then to consider their reactions in the short-term to movements of Sterling down against a local, importer's currency, giving a devaluation effect, and movements of Sterling up against a local currency, which produces a revaluation effect.

The empirical results are given in Chapter 5 (pages 172-179), with the implications of different price actions under different conditions, and the conclusions drawn are in Chapter 6 (pages 225-228).

## (9) Export Invoice Currency Determination and Market Strength

Finally, interest is shown in the geographical concentration of invoicing in different currencies and the impact of market forces on the sharing of the benefits and costs of currency movements during floatation.

The suggestion advanced is that exporters are subject to customer and distributor pressure to an extent where the invoice currency represents the advantage to the importer.

In fact, the data collected in this area were extremely limited both in quantity and reliability.

The results are presented in Chapter 5 (pages 180-189) and comments are made in Chapter 6 (pages 229-230), but these are necessarily of an exploratory nature and no conclusions can be drawn in this part of the study.

(10) Export Policies by Industry

In view of the stratification of the sample used, an attempt is made to contrast the exporter characteristics, export strategy and pricing policies associated with the different industries studied.

This is shown in Chapter 6 (pages 231-235).

# CHAPTER 1

## OBJECTIVES OF THE RESEARCH

# INTRODUCTION

This study has its origins in the researcher's involvement in, and observation of, export strategy and pricing decisions in industry, and dissatisfaction with the available theory to assist the decision maker.

It is intended that this study should contribute to an understanding of the export process in smaller firms, if only in a limited way, and more specifically should provide a comparative base to act as a benchmark for managers to assess their export strategy and pricing decisions against those made by others. To this end, some emphasis is placed on conditional or situational analysis, rather than normative generalisation.

There may also be some value in the work of a predictive kind, regarding the exporter characteristics associated with particular strategies and pricing behaviour in response to changes in the marketing environment.

The research aims in this way to contribute in a limited way to both the academic and practical aspects of export management in the medium-sized manufacturing firm.

## 1.1 AIMS OF THE STUDY

In the context of the origins outlined above, this research study seeks to study the export strategies pursued by firms, and particularly the export price policies adopted, with some emphasis being placed on the way in which these are related, together with the effect on both of them of such factors as the firm's export objectives, the stage of internationalisation, the availability of information, the perceived role of price competition as contrasted with non-price competition, and the impact of currency floatation.

The study develops six major research objectives, concerned with export objectives, export strategy, export price levels, export price methods, export invoice currency strategy, and invoice currency and market strength. Each of these objectives is associated with a number of hypotheses, which the primary element of the work seeks to test. The research objectives and hypotheses for testing are developed in the literature survey.

## 1.2 CHOICE OF RESEARCH FIELD

Three aspects of the research field are significant at this point: the type of companies to be studied, the geographical area from which they are drawn, and the industries which they represent.

The companies are medium sized exporters in manufacturing industries.

For the purposes of this study, medium sized is defined as companies employing between 100 and 2,000 employees in the UK. The lower limit is based on the Bolton Committee (73 ) descriptions of small businesses and the upper limit is imposed arbitrarily as a dividing line between the medium sized and larger manufacturer.

This concentration on the medium sized business is based on the hypothesis that it is this sector where exporting is likely to be most significant, as opposed to international or global operations. The smallest firms are excluded partly on the grounds of the typical lack of structure found in their policy making and partly on the Bolton grounds that small business requires specialist study, which here would necessitate the inclusion of a further field of literature and study beyond that extensive coverage of pricing and export management already planned.

In this study exporting is defined as the sale of goods to users and independent distributors outside the UK. Thus inter-group transfers are excluded together with the related issue oftransfer pricing.

The geographical coverage of the primary research is the North of England, defined for present purposes as a combination of the Registrar General's Standard Regions: Northern England, Yorkshire and Humberside, and North West England.

This concentration has the objective of giving the project and its results a regional orientation and application.

The industries chosen are intended to represent both consumer and industrial markets, and both durable and non-durable goods. The industries chosen are Clothing and Furniture, in the mainly consumer area and Chemicals and Scientific Instrumentation in the primarily industrial area.

Further details of the size distribution of respondents, the geographical coverage, and the definitions of the industries studied are given in Appendix VIII Postal Survey Sample Design.

## 1.3 RESEARCH METHODOLOGY

The exploratory stage of the study involves a literature survey: firstly, in the various disciplines contributing to the received theory of pricing, (discussed in Chapter 2), and then in the fields of export management and export pricing, (reported in Chapter 3). This literature analysis led from the general aims of the project to the formulation of the specific primary research objectives and hypotheses for empirical testing. The exploratory work was concluded with a small number of depth interviews with executives in firms representative of the markets to be studied, with the aim of refining the hypotheses and research variables.

The hypothesis testing work consisted of a postal survey of senior executives in firms of the type defined in 1.2 above.

An analysis of the results of the depth interviews is given in Chapter 5 and Appendix VII.

Details of the survey design and sampling are given in Chapter 4 and Appendices VIII and IX. The results of the postal survey are descibed in Chapter 5 and Appendix X.

The interpretation of the results and the conclusions drawn are discussed in Chapter 6.

# CHAPTER 2

## PRICE THEORY AND MANAGEMENT

## 2.1 PRICE THEORIES

## INTRODUCTION

The objective of this section of the paper is to describe and compare the concepts of the meaning and behaviour of price, which are used to develop price setting methods, for later application in the specialist area of export pricing.

This review necessarily draws on the concepts and tools of various disciplines. There is a degree of arbitrariness in the assignment of theories to categories, but this classification is defended here on the grounds that the discipline framework reflects the contrasting views of price taken and advocated in the literature. It is accepted that some reject such divisions as artificial, for example Alderson ( 7 ) and Gabor (196), but this framework provides at least a starting point.

The review distinguishes between price concepts drawn from economics, finance and accounting, the behavioural sciences, marketing and management theory. This last section includes a survey of the available empirical evidence of actual pricing behaviour.

## 2.1 (a) ECONOMIC THEORY

Studies of price commonly begin with economic theory, even in the absense of a prescriptive theory for decision making (228). Some dislike this base: Oxenfeldt (403) feels that while pricing is "largely the domain of economic theorists", he feels that:

> "The current price literature has produced few new insights or exciting new approaches."

Similarly, Monroe and Bitta claim that:

> "The reasons for this lack of creative development are: (1) for some time the economists' theory of price has dominated despite the lack of realism in the theoretical structure and
> (2) until recent environmental changes, the seller's problem was not price but rather demand stimulation." (335)

The structure used in the assessment of economic contributions in this study is the distinction between the classical supply and demand model and normal cost (or target return) theories, as made and defined in (35), (153), (154), (155) and (207).

Supply and Demand Models of Price Determination

The classic supply and demand model emphasises price as an allocating device in the economy, with a tendency to equilibrium where supply equals demand at a given price.

It is argued that economic price theory was developed to give general theories (228), for welfare economics (230,238) and for a simpler economy than now exists, based on perfect competition in commodity products (257,480). One apposite comment offered by Monroe and Bitta is:

> "There is an elegant tradition of pricing models in economic theory, but these models do not provide operational models for management to follow." (369)

Accepting differences in objectives, economic theories are pursued here for the insight they may offer, rather than for exact decision rules.

The Role of Demand in Price Determination

The supply and demand approach depends largely on prices varying in response to demand, which provides an area of some controversy.

Coutts, Godley and Nordhaus (119) and Nordhaus and Godley (389) group economic views into three groups: firstly, those stressing the role of competitive forces; secondly, those based on target profit objectives; and thirdly, those seeing price as determined by normal (or standard) cost, that is, the normal price hypothesis.

Certainly, some work appears to suggest that prices respond to competitive forces, for example, Stigler and Kindahl (516), Rushdy and Lund (460) and others ( 33,162,335,381), although others like Neild (384) claim that demand has no direct effect on price.

Here, a working proposition advanced is that of Ginsburgh and Zang (207): that the supply and demand approach is well-suited to the competitive economy, while the normal cost or target return models are better suited to oligopolistic markets.

## The Role of Cost in Price Determination

Eckstein and Fromm (155) argue that the continuous clearing process of the supply and demand model is efficient only whem price change costs are negligible, suppliers and buyers remain in communication, and losses from failing to transact are high. Otherwise, it is argued, continuous clearing is inefficient, and in oligopoly, where competitors are interdependent, the commonest approach is target pricing, as confirmed by Kaplan et al (287), Lanzillotti (323), Wilkes and Harrison (575) and others. Eckstein and Fromm (155) claim that the advantages of such approaches include: internal policy consistency, facilitating price leadership, price stability, and suitability for quotations; while Lanzillotti (323) explains their importance in terms of facilitating investment planning and performance assessment, historical pressures, a belief in a "fair" return and a tradition of production orientation and tacit industry agreements. Full-cost pricing is said to be a variant of the target approach (155).

These points may be related to the normal cost concept mentioned earlier:

> "normal-cost pricing hypothesis is of course a member of the full-cost pricing hypotheses that have attracted support since the 1939 paper of Hall and Hitch." (381)

Support for the claim that cost is the main determinant of price comes from many sources: Hall and Hitch (232), Chamberlain (100), Barback (43 ), Eckstein (156), Lanzillotti (323), Ripley and Segal (449), Laden (315), Ball and Duffy ( 35) and more recently Nordhaus and Godley (389) and Coutts et al (119):

> "the evidence did not support the view that demand affects prices relative to normal unit costs: the effect of demand on the mark-up was both statistically and economically insignificant."

However, others have emphasised the combined role of costs and demand in price determination: Eckstein and Fromm (155), Ginsburgh and Zang (207), Shinkai (488), Sheriff (484), and McFetridge (379) for example.

## Administered Prices

Means' concept of administered prices (354,355) suggests industrial prices do not follow the classical economic model. Vaile et al explain:

"Price policy and administered pricing mean that there is some discretionary latitude in pricing, within which meaningful decisions are made by the enterprise." (557)

Similarly, Howe suggests:

"we have now by and large a system of administered pricing with prices being established as a result of conscious, positive decision making within firms" (257)

The existence of administered prices is seen by Wilkes and Harrison (575) as explaining the differences between classical theory and observed management practice. While some have disputed the existence of administered prices, most particularly Stigler and Kindahl (516,518 ), others have provided supporting evidence: for example, Weiss (566), Cockfield (108), Harper (238), Jones and Laudadio (278) and Bridge ( 80), and this concept seems central to the analysis of market imperfection and management of the price variable.

## The Assumptions of the Economic Model

The most frequent criticisms of the supply and demand model are directed at its underlying assumptions, divided by Gabor (196) into those of the supply side, like profit maximisation objectives, single product decisions, and perfect information; and those assumptions on the demand side, like perfect buyer knowledge, the absense of experience or expectations effects and buyer rationality. The attacks based on cost-determined prices, and price making rather than taking, have already been acknowledged above, and this section reviews these other points, except that the profit maximisation issue is considered in 2.2 below and product-line pricing in 2.3.

Marginal Cost Assumptions - Attacks on the assumption that marginal cost in known and used as the basis for price are widespread, as reviewed for example by Barback ( 43). According to Howe, the lack of data and the fear of failing to cover fixed costs are:

"the real reasons for businesses not adopting a marginal cost approach to price." (257)

This is of importance both in the general discussion of full-cost and marginal cost price models immediately below, and in the later issue of the relationship between export and domestic price. Although it is recognised that economists like Machlup (336) have defended marginalism, here it is pointed out that:

"it is awkward to assume perfect knowledge in the theory of the firm" (133).

Marginal Revenue Assumptions - Howe notes that:

> "Few firms can know the values of MC, or particularly MR, as the latter depends on an awareness of the slope of the demand curve." (257)

Economists like Axell ( 29), Rothschild (458) and Sheffrin (483) give attention to extending incomplete information conditions into market models, and Cornell has recently argued:

> "One of the most discouraging implications of the theoretical work on the economics of information is that many of the conclusions of neoclassical theory are not robust when the assumption of perfect information is relaxed." (118)

Adjustment Costs - Sheshinski and Weiss (485) show that price adjustments are not costless, but are associated with the transmission of price information to buyers, as well as the firm's decision process. Similarly, Arnold ( 23) notes that the fixed costs of a price change tend to be materially greater than those of a change in output, and Ip (268) shows that price stability is generally desirable because of adjustment and transformation costs, refuting the normal assumption (537).

To the extent that the costs of adjustment contribute to price rigidity, this may be associated with administered prices.

Interpretation of Price - Silberston urges that:

> "It is important to realise that price is not an unambiguous concept"(490),

pointing out that price has many dimensions, ranging from the terms of trade and service content of products to the difficult issue of the price/quality relationship.

Perfect Buyer Information - The first of the demand side assumptions is that of the free availability of information. Stigler (517, 519 ) sees price knowledge as a function of search activities and the residual price dispersion as a reflection of the process of knowledge becoming obsolete and the changing identities of buyers and sellers (350). If the significance of search is accepted, then attention must be directed at differences in the motivation to search (168), the psychological costs of search ( 58) and the whole range of "secondary consumer costs" ( 61) associated with such activities.

Similarly, negotiated prices share some of the characteristics of the lack of information:

> "prices are often openly decalred in price lists and yet most of the actual bargains are the result of negotiation" (196).

This suggests some need to qualify the normal assumption.

Present Considerations - The assumption that the buyer makes decisions only from stimuli in the present is denied by behavioural work on the influence of buyer expectations and past experience, for example by Cochrane and Bell (107), Katona (289) and Adam ( 4 ), and in economic terms by Stigler's argument that past experience is stored search. Further evidence suggests that price setters anticipate a broader time horizon for price decisions, shown for example by Pickering (432), Hess (246) and Kotler's "elasticity of expectations" (306). The concepts of search and learning in some circumstances deny the dominance of stimuli in the present.

Rationality - The assumption of rationality in the sense of the pursuit of Hicksian equimarginal utility is challenged as arbitrary by Gabor:

> "seemingly inconsistent behaviour may only mean that the observer is not aware of the criteria by which the consumer forms his judgements" (194).

Further, there are various intermediate views of rationality, like Simon's satisfacing (490) and Katona's conclusion that much purchasing is repetitive (288). Rationality in the sense of price indicating product quality or other attributes like "price dependent preferences" (434), is considered further as a behavioural and marketing phenomenon, and the philosophic issues of economic and noneconomic rationality are discarded here.

Product Differentiation - The simplifying assumption of product substitutability ignores the fact of product differentiation, while:

> "Good marketing practice calls for trying to endow the company's product (or brand) with real or psychological differences" (307).

The general argument advanced by marketing writers is that product differentiation reduces substitutability and desensitises the buyer to price differences: Livesey (332), Kotler (306), Sampson (464) and King (298). Product differentiation may be related to services and product attributes or to brand differences, but its existence has disruptive implications for the simple economic model, recognised shortly in the concept of monopolistic competition.

Price and Product Quality - Attention will be given to price as "an indicator of quality" (195) or "communication cue" (143), in the behavioural aspects of price, while the concern here is with objective quality differences between products, which Cowling and Rayner argue has been given little attention (121). Accepting the product as a grouping of characteristics and attributes (175,321 ), Cowling and Rayner estimated implicit prices for product characteristics, reflecting consumer utility, and found that price and quality determined market share (121,122 ), together with advertising: Cowling and Cubbin (120), Cubbin (129) and Cowling and Waterson (123). If quality-adjusted prices partly determine market share, this restores to some degree the validity of the economic model, but is significant here in what New (386) sees as the essential balance between price and quality in the later emphasis to be placed on non-price aspects of competition in the international market (in 3.1 below).

## Collusion and Concentration

The normal development of the economic model involves relaxing the assumption of perfect compettion. Silberston (490) points to the work of Sraffa (513), Chamberlin (101) and Robinson (450), which:

> "threw doubt upon the validity of the analysis of price determination based on the assumption of perfect competition".

This leads to imperfect competition models and particularly in this context, their implications for price-cost margins, price collusion and price stability.

Imperfect Competition - Scherer claims that:

> "Pure competition is much rarer than oligopoly .... Pure monopoly is even harder to discover," ( 468)

and he argues that the majority of industries are divided between the monopolistically competitive and the oligopolistic, as defined:

| Type of Product | Number of Sellers | | |
|---|---|---|---|
| | One | A Few | Many |
| Homogenous | PURE MONOPOLY | HOMOGENOUS OLIGOPOLY | PURE COMPETITION |
| Differentiated | | DIFFERENTIATED OLIGOPOLY | MONOPOLISTIC COMPETITION |

Chamberlin's "monopolistic competition" is particularly related to product differentiation, as discussed earlier. Scherer points out that oligopoly theory departs from a point of high market concentration, interdependence of sellers' pricing decisions, and the sellers' recognition of that interdependence, and although collusion may be limited by firms' conflicting price and output preferences:

> "Factors conducive to cooperation include free and rapid inter-firm communication, repetitive transactions, the cultivated expectation that price cuts will be promptly countered, the willingness of industry members to substitute inventory and order backlog fluctuations for hair-trigger price adjustments, and reliance upon order and inventory feedback signals instead of myopic marginal rules as guides to output determination." (468)

<u>Price-Cost Margins</u> - The classic argument advanced is that:

> "higher levels of concentration in industry tend to be associated with higher prices of products .... and with higher profits;" (585)

However, empirical evidence is mixed: support comes from sources like PIMS (Profit Impact of Market Strategies) (489), Gale (200), Buzzell et al ( 93), Boston Consulting Group ( 75), Marvel (349), and in the U.K., Shaw (482), Khalilzadeh-Shirazi (297), Hart and Morgan (243), and recently Nickell and Metcalf (387). On the other hand, others have found little empirical support for the contention: for example, Day (139), Hamermesh et al (233), Holtermann (254), Shinkai (488), Shinjo (486) and Lall (317).

It may be that differences in price-cost margins are influenced by other factors, like managerial objectives (see 2.2 below) or the existence of "workable competition" (190), since:

> "The more workably competitive an industry .... the more price will approximate to that which will rule in conditions of perfect competition." (490).

Additionally, the concept of "limit pricing", as developed by Bain ( 31, 32 ) and Sylos-Labini (526) offers some explanation for low prices occurring in concentrated markets. Here, Osborne (400) points to situations where limit pricing is attractive to firms, and Spence (511) emphasises the mere threat of price competition as a limit. While Shaw (482) found no limit pricing in the U.K. retail petrol market, Stobaugh and Townsend (520) claim to have confirmed its potency in petrochemicals.

<u>Interdependence</u> - Secondly, there is the question of the existence of interdependence leading to price leadership and the Hall and Hitch kinked demand curve (232).

Scherer (468) points out that price coordination may involve outright collusion, price leadership, mutual adherence to full-cost rules and adherence to focal price levels, and Markham (345) has specified the conditions facilitating such coordination in terms of small numbers of sellers, the existence of barriers to entry, a relatively homogenous product, low price elasticity and similar costs throughout the industry.

That collusion exists is suggested variously: Cockfield ( 96, 106), Boyle and Hogarty ( 78), Cubbin (129), Maccini (335), Pekelman (426), although Marvel, for example, found collusive agreements to be inherently unstable (349).

One suggestion commonly advanced is that such interdependence leads to "sticky" prices, where prices are generally inflexible, or where price decreases are expected to be matched by competitors while price increases will not be, as formalised in the kinked demand curve concept. This model has been criticised by some, but Cyert and Cohen (110) suggest it is valid in those situations where no learning has taken place about rivals, and Silberston notes:

> "The implication is that in more mature industries firms have sufficient information about their rivals to remove much of the uncertainty which gives rise to the 'kinked' pattern of behaviour." (490)

Certainly, many claim that oligopoly is associated with rigid prices. Means' basic thesis (354, 355) was that administration-dominated prices tend to be relatively inflexible, which has received empirical support from others like Jones and Laudadio (278), Shinjo (486), while Pekelman (426) argues that price stability itself reinforces concentration.

Others have suggested that market concentration does not necessarily involve rigid prices, for example Cocks and Virts (109) in pharmaceuticals and Mason (351) more generally regarding the incidence of hidden price cutting. Some consider that "stickiness" may be assymetrical, although the evidence is mixed.

Perhaps the most interesting implication is that competition may be on on non-price grounds, and this is pursued shortly.

Summary

A distinction exists between classical supply and demand models and normal price models, reflecting essentially the debate of whether prices are demand or cost determined. The underlying assumptions of the classical approach have been reviewed, with some mention and recognition of the major developments in each area.

Lastly, the theories of imperfect competition were examined in the context of price administration, collusion and price leadership and price rigidity.

This provides one base from which to analyse the issue of export pricing in the later parts of the paper.

## 2.1(b) FINANCIAL AND ACCOUNTING THEORY

Given the existence of price administration, this section reviews the concepts of cost measurement used and their associated pricing methods, leading to an analysis of the situational indicators of the relevant cost concepts.

### The Role of Cost in Price Determination

The debate here parallels that conducted earlier in economic terms. There are those who claim that costs are irrelevant to setting prices:

> "cost figures are really irrelevant because prices are determined by market forces - the 'invisible hand' of Adam Smith" ( 2)

> "The deciding factor in price-fixing is the price which the customer is willing or can be induced to pay" (162)

> "there is no relationship between unit cost and selling prices obtainable in the market" (494).

Similarly, Johnson (276) argues that market-oriented pricing is the only satisfactory basis for management. An example is offered by the Harrison and Wilkes case history of the Jaguar XJ12 (239, 240), which showed a low price based on costs stimulating demand beyond production capacity.

On the other hand, others see cost as a dominant factor in pricing at the company level:

> "In the majority of British businesses, prices are decided primarily on the basis of cost, plus a percentage for profit" (353),

while Oxenfeldt and Baxter (401), Gillis (206), Backer ( 30) and Dean (140) have made similar statements about American pricing.

There certainly appears to be appealing logic in the arguments that costs are the prime determinant of price, leading recently to claims of a "rebirth" of cost accounting ( 18) and Cutler's view:

> "by assembling the internal cost structure .... we now have a sound footing to work from" (132).

Dean explains the attraction of cost-plus formulae in terms of providing an ideal, rather than a method ( since formula prices are adjusted for other factors), long-term security, and the last resort in ignorance of demand elasticity and competitive structure, while Wilkes and Harrison (575) emphasise factors like the appearance of equitability and price stability.

Dean's view of an ideal rather than a method is reflected by others:

> "costs are by no means the sole or even the main determinants of price" (181),

> "There is very rarely a rigid relationship between selling prices and product cost because competition and the elasticity of demand enter into selling price decisions," (500),

> "that this informal stage in price-fixing frequently exists, and is often significant, few who have had much actual experience of business would deny." (162).

The difficulty of direct observation of the price decision has long been recognised (145, 425), but many now emphasise the interaction of cost and other factors (503), and the role of cost as indicating the profitability of price options (140, 174, 181, 300, 569).

The role of cost in pricing continues to attract controversy, although the existence of a role of some kind is difficult to deny in the context of industrial practices.

Cost Concepts

Lere (330) advances a form of situational argument that rather than simply prescribing a cost approach to price, the real problem is that of choosing the most valid cost model in a particular case. This is reflected in Davies (135), Abel ( 2 ) and certain others (140, 402). There is a remaining need to distinguish the major cost concenpts before considering how to choose between them.

Absorption Costing

Sizer has noted:

> "Despite the apparent advantages of marginal pricing .... full costs appear to be used by most firms when developing product prices" (500).

Full costs, following Hart (241), involve the accounting process of allocating direct costs to cost centres, apportioning overheads to departments (through some notion of causality (255)), re-allocating service department costs to production departments and absorbing from production departments to jobs or products on some "equitable" basis.

The logic of this lies in the "recovery" of all costs in unit prices set (257) and other justifications like fairness (140, 155). More recently absorption costing has been defended as:

> "a method of imposing a charge for the use of facilities which may have alternative uses .... Absorption costing may then be justified not on the grounds of equity but as a rationing device." (332)

> "it does not do what it professes to do, but it may do something better; the traditional costing margin - overhead plus profit - may serve as a rough guide to opportunity cost." (401)

However, the literature provides many examples of criticisms of absorption costing.

Firstly, the essential arbitrariness and thus invalidity of allocations and apportionments has been attacked:

> "Absorption costing attempts to determine the unit cost of each product, but since its rules are essentially arbitrary, the results can be dangerously misleading," (196)

> "there cannot be a'correct' method of apportioning joint costs and for decision purposes the main criticism levelled against them is ..... appearing to give a degree of precision to these costs which they do not possess." (466)

Secondly, it is argued that absorption costing confuses different cost types. Sizer (500) notes the ambiguity of the term overhead, and the consequent tendency for accountants to include all indirect costs (including, for example, incremental management and marketing costs) as compared to the economist's view of overheads as fixed costs only.

Many arguments have been put forward for excluding fixed costs (or at least non-incremental costs) from short-term decision making:

> "All past outlays which give rise to fixed costs are historical and unchangeable. They are inescapable 'sunk costs' regardless of how they may be costed for accounting purposes" (500).

To the same end, another writer emphasises the distinction between variable costs as the "costs of doing business" as opposed to fixed costs: "the costs of being in business". This issue is to be pursued in the context of choosing between cost models.

## Marginal and Incremental Costing

The underlying logic of those who oppose full-cost approaches is that only those costs affected by a decision should be included, particularly in the context of a price decision. Livesey points out (332) that incremental cost refers only to the additional cost to be incurred, which is by definition the amount to which the particular decision refers, and which therefore should be the centre of attention. Livesey includes here specific costs (including variable marketing and distribution costs) rather than simply direct cost (variable production costs (255)).

Gabor differentiates incremental and marginal costs:

> "According to the economist's definition, marginal cost is the difference in total cost occasioned by increasing output by one unit per period .... Incremental cost may refer to a batch of any size." (196)

The practical difficulties in adopting an approach of this kind (mainly those of accounting for opportunity cost, the long-run effects of the decision, and the real value of the factors of production (136), and of classifying costs) are relevant to the following sections.

## Full-Cost and Marginal/Incremental Cost Pricing

Cost-plus and target pricing methods (target pricing being a close relation of full-cost pricing (162)) are defended for appearing to cover

> "The correct reasoning is that cost results from a decision to produce an item under particular circumstances and does not adhere in the item itself." ( 402)

Similarly, Wentz (569) claims that the proper role of costs in pricing is to determine the profit consequences of alternative prices, and that it is only incremental costs which determine these profit consequences. Gabor follows this logic with the suggestion that direct cost pricing is:

> "not so much a method of price determination as rather a guide to choice between orders competing for the use of the same facilities." (196)

Correspondingly, the major criticism of these approaches is the danger of failing to recover all costs, although it may be thought equally dangerous to assume that the customer will pay any price asked.

It is perhaps worth concluding with Livesey's observation:

> "Despite the passion the debate generates, one sometimes has the feeling that there is a certain amount of shadow boxing and that the contestants may have more in common than perhaps appears." (332)

Livesey points out that different approaches may lead to different prices but that this is not necessarily the case. If there exists a zone where prices are not greatly affected by the cost accounting used, it may be that other aspects of determination are of more interest. Certainly, there appears no basis for the claim that full-cost or marginal cost prices are more profitable ( 332).

This debate will be of relevance to comparing domestic and export pricing later in the review, particularly in the context of the prescription of marginal approaches for export pricing.

The Choice of Relevant Cost Concept

Since options exist, there may be value in looking for indicators of the relevant cost concept in different circumstances, reflecting what has been termed "situational theory" (363 , 364 ) or a contingency approach (274 ), as an attempt to integrate the economic and financial viewpoints.

Dean recognises four cases of market structure influencing pricing. Firstly, in perfect markets no pricing discretion exists ( 140) and "cost cannot be the basis for pricing" ( 401), since the firm is a price taker.

all costs, "fairness", ease of administration, avoiding price wars, and perhaps accounting for opportunity cost. Recently, some have written of a "rebirth" of traditional cost accounting ( 2, 17, 18 ) and a related "comeback" for target pricing ( 69 , 286 ) and it will be seen shortly that such approaches appear to attract wide support in industry.

One stance shared by many is that a number of criticisms are overcome because formula prices are adjusted before quotation to customers, for example, Howe (257), Andrews ( 14), Barback ( 43), Eckstein and Fromm (155) and Foxall (181 ). While this is probably descriptively true, it appears less acceptable as a rigorous defence for the use of the pricing methods concerned.

Among the many criticisms of full-cost pricing are: the arbitrariness of cost allocations (135) leading to overestimated precision (140), ignoring demand (135, 140), and perhaps most seriously, combining fixed and variable costs to produce an irrelevant cost concept (140, 257, 500, 575).

The inclusion of fixed, "sunk" costs in pricing decisions raises difficulties, for example:

> "if overhead costs are high in relation to direct costs then a slight change in estimated output could have a large impact on the full-cost price" (257).

However, it is true that:

> "what is fixed and what is variable depends on the time period being considered because in the long run all costs are variable" (136),

and that the fixed/variable distinction may differ by cost centre (465), and some costs may change categories over time ( 65), which provides operational difficulties for the options to full-costing.

As far as ignoring demand is concerned, Sondoki claims:

> "The main criticism against full-cost pricing is that it disregards demand. It is a mechanical pricing method and .... the price arrived at is not necessarily the best" (507).

In fact, many would claim that it is the "adjustments" to formula prices which take account of competition and demand.

The shortcomings of full-cost pricing lead many to advocate the use of forms of marginal, incremental and direct cost pricing, for example Tucker (550), Anderson ( 12) and Oxenfeldt:

Secondly, Dean is concerned with products of "lasting distinctiveness", or monopoly, although he finds classical monopoly theory inadequate.

Accepting these as limiting cases, the major interest is in the intermediate cases of "pricing products of perishable distinctiveness" and "pricing standard products when competitors are few". The former is concerned with the progress of an innovation through a cycle of "competitive degeneration" and leads to the development of Dean's classic thesis of market skimming and market penetration strategies in pioneer pricing. In maturity this borders onto the last market situation, amounting to oligopoly, where competitors have "by painful experience developed a pronounced aversion" to price cutting.

To these market structures may be added theories of cost-based pricing of various kinds and market-based pricing.

As noted, in the competitive market, Dean (140) and Oxenfeldt (401) emphasise price taking. Lere (330) argues similarly for a uniform product on an open market with no price controls, although he notes the possibility of refusal pricing, since the firm may choose to deal or not to deal at the prevailing market prices, and Lere claims that the relevant cost concept is direct cost to assess the total contribution available. In simpler terms, Kelley (296) argues that in a "buyers' market" a firm should aim at the greatest contribution to profit and overheads. Sizer adds a time dimension to this, which is considered shortly (500).

In monopoly, Dean (140) cites the usual marginal model, but Abel (2) claims that in regulated monopoly the determination of full-cost is important, since the objective is the recovery of all costs plus a margin for profit. This logic is reflected in Kelley's view that in a "seller's market" the firm should price for the highest possible return on investment.

Within the "perishable distinctiveness" category (140), or novelty pricing (330), or monopolistic competition with product differentiation (2), emphasis is placed on demand analysis and market-oriented pricing, particularly regarding skimming and penetration choices. Abel adds the point of the manager's need for cost information about the impact of volume changes, implying a need for incremental costing, while Lere argues that demand analysis shows what price can be obtained and the role of cost is to evaluate the acceptability of this, so direct costing is preferred.

In oligopoly, Dean stresses the tendency to price leadership, the avoidance of price changes, the emphasis on non-price competition, and underground price competition. Lere claims that the price leader is best served by absorption costing to arrive at a price covering all costs, as in the monopoly case, while for the price follower whose decision is whether to accept or reject business at the going rate, the relevant cost concept is direct costing. This last point is also made by Abel.

Finally, to this can be added Sizer's distinction between primary and secondary pricing decisions (500) and his claim that:

> "full costs usually form the basis for what might be classified as 'primary' pricing decisions, for standard products sold in the home market, while where marginal costs are used in pricing it is for the 'secondary' type of decision".

Sizer refutes the claim that full costs are used simply because they are what accountants provide (575), and his case is that primary decisions are made with full costs because they are perceived as long term and managers want a satisfactory return on investment in the long term (and if the long term is long enough all costs are variable anyway). The secondary decisions in this schema include: tenders, by-products, sub-contracting, and by implication exporting.

<u>Summary</u>

This section reviewed various cost concepts and their pricing applications, particularly in terms of the continuing full-cost versus marginal cost or incremental cost debate.

There would seem some grounds for building a situational framework for distinguishing the areas of application of the different cost concepts for pricing. This is of particular relevance here to the issue of export pricing compared to domestic pricing.

## 2.1(c) BEHAVIOURAL SCIENCE CONTRIBUTIONS TO PRICE THEORY

This section is concerned with the role of price as a cue for the buyer, and it is noted that comments made earlier about the shortcomings of the economic model in behavioural terms become relevant here.

Oxenfeldt has observed:

> "Models developed by economic theorists rarely direct a pricing executive's attention to the key variables. Behavioural science offers far more insight into the factors that determine how price changes will be perceived and reacted to by consumers." (403)

Following this logic, the interest here is in buyer price awareness, price sensitivity and the interpretation of price as a communication cue.

### Price Awareness

Monroe (365) points out that price consciousness is related to price perception and sensitivity, and others argue that prevailing awareness is an indicator of the role of price in the marketing mix (332, 403):

> "information on price awareness may be a useful guide to marketing activity by indicating those products for which a policy involving a strong emphasis on price would be most, or least, appropriate." (332)

If this is accepted, then a brief consideration of the sources and variations in price awareness is valid.

Low price awareness has been noted by many researchers, for example: Goldman (210), Hansen (235), Engel, Blackwell and Kollat (168), Livesey (332), Thorncroft (536) and Brown ( 82) in consumer markets, and Buckner ( 88), Swallow (525) and Cunningham and Whyte (131) in the organisational decision making unit.

Variations in price awareness have been attributed to many factors. Gabor and Granger considered frequency of purchase a significant positive indicator of price awareness (189, 192, 193, 196), while Cooper (115, 116) looked at types of product within these categories in terms of awareness influenced by the degree of "begrudging" in purchase.

There have also been claims that price awareness varies by buyer type: Gabor and Granger (192, 193) found price consciousness inversely related to social status, and Frank et al (182, 183) related cost consciousness to income and occupation, although Trier et al (549) disputed such a relationship and Murphy recently concluded:

> "it is unclear what relationship exists between socioeconomic status and price sensitivity" (374).

In industrial marketing, Swallow (525) claims that the perception of price will be a function of the organisational environment, the executive's personal qualities and the purchasing methods used.

This issue has importance in the later consideration of the power of export pricing and immediately in leading to the closely related issue of price sensitivity.

Price Sensitivity

The concern here is with individual and group reactions to price:

> "Price sensitivity indicates the likely response of consumers to changes in price. Price elasticity of demand .... is a precise measure of this response." (332)

This section reviews the sources of sensitivity and its applications in "psychological pricing" and "desensitising" buyers.

Gabor (194) argues that the central aspect of demand theory is that the consumer's subjective price scale is logarithmic, with the implication that a proportional change in price will have a constantly proportional effect on the rate of purchasing, independently of the absolute level of price. This is commonly expressed as an application of Weber's Law (168, 284, 375).

Gabor has illustrated "the tendency to react to relative rather than absolute price changes" (197) in terms of "psychological pricing": for example, choosing price points as near as possible to 5% below the nearest round figures, as in pre-War hosiery pricing (252). Others have called this "odd pricing" ( 4, 143, 301, 480). Little evidence is available on the validity of such approaches.

A challenge to the Weber's Law concept was provided by Kamen and Toman's "fair price theory" (284, 285), whereby consumers have some preconceived ideas of a reasonable price. This challenge was rejected by others in the field (190, 370, 515), but appears not unconnected with the threshold or limit theories considered below, since:

> "though seldom discussed, the concept of a just level of prices, i.e. what things ought to cost, is permanently present in the minds of most consumers," (196).

This is reflected in Cooper's "begrudging index" (115, 116) and Radford's well-known analysis of the development of "just" prices in a prisoner of war camp. There may also be a relationship with Delozier's quantum effect (143), where consumers are insensitive to prices below the quantum, but highly sensitive to prices even slightly above it.

Thus, price sensitivity is concerned with the degree of reaction to price changes and is illustrated by "psychological pricing", the concept of Weber's Law, and that of "just" prices. The direction of buyer reaction is the concern of the next section, though the implications of price sensitivity for the seller are reviewed first.

Sampson's classic paper (464) proposes that rather than finding the gradual, continuous relationship between market share and relative price, the customary emphasis is on critical prices, explained by the imperfecions in price sensitivity caused by desensitising factors such as point of sales appeals, local promotion and services and consumer loyalty (143, 561).

A related point made by Bender ( 61) is that consumers seem to differ according to whether primary purchase costs (the price) or secondary purchase costs (non-price financial costs, time costs, and psychological costs) are the more important. This is confirmed to some extent by Shapiro's conclusion (479) that reliance on price is a generalised attribute of certain consumers. Recently, Monroe (367) has claimed that responses to price changes are assymetrical: brand preferences being more sensitive to price decreases than price increases.

In this way, price sensitivity may be compared to the economic concept of price elasticity of demand, so the next issue must be the direction of reaction to price.

## The Interpretation of Price

The concern here is price as a communication cue and the implication of this for the reaction to price:

> "the consumer, in many cases, perceives price in a non-economic manner. Price, thus, is a powerful piece of information for the consumer." (480)

Here, the specific interest is in price as an indicator of quality, and as a determinant of product and brand preferences.

Price As An Indicator of Quality - Investigations of price as a quality signal can be traced to Scitovsky in 1944 (471) and Leavitt in 1954 (325), and various pieces of work in the 1960's: Tull et al (551), Olander (397), McConnell (377), Dean (140), Fog (177), and the "most original and fruitful approach to the study of price and consumer behaviour" (196) by Stoetzel, whose research was concerned with establishing the existence of a band of prices which consumers were willing to pay (521). This line was pursued by Adam ( 4), Fouilhe (179) and more recently, Gabor and Granger (195) and Monroe (368).

The Gabor and Granger approach rests on the proposition that each potential customer enters the market with an upper price limit, above which the product is too expensive, and a lower limit, below which there is a distrust of the quality of the product, so that outside these limits price acts as a primary barrier to purchase.

In operational use it is argued, for example by Mason (352), that the importance of price as an indicator of quality is inversely proportional to the degree of product information available to the buyer and his confidence in his criteria of evaluation. This has been confirmed by those like Peterson (429), Cornell (118), Engel et al (168) and Lambert (320), while Gardner (201) has disputed the general application of the price/quality relationship, which may, for example, be replaced by a brand/quality relationship. Similarly, Lambert (320) points out that little attention has been successfully focussed on differentiating products with negatively and positively sloping demand curves.

Recently, it has been claimed that:

> "Despite the evidence available from the specific effect of price on choice studies .... we know very little about how price affects a buyer's perception of alternative purchase offers, and how these perceptions affect his response." (365)

Similarly, Olson (398) regards single-cue studies as being of limited practical use, since the main concern should be with the interaction of price with other informational cues. Attention is directed to multi-cue concepts.

Price and Brand Perceptions - A broad grouping of studies see price as a cue or signal interacting with other signals, from which is drawn the hypothesis that this interaction (or lack of it) may help to differentiate between cases where price acts as a quality or image determinant and those where it does not.

Brown ( 28), Schlackman (469) and Nystrom (391, 392) have reported that generalised store perceptions may influence price perception and awareness, while Shapiro (477) emphasises a "worth the money" variable.

Recent work by Monroe (367) suggests that understanding the role of price in purchasing necessitates an appreciation of the information the buyer brings to the purchase situation, in terms of use-experience, prices and attitudes. The role of expectations in determining consumer responses has been emphasised by Katona (289) and Emery (166), while Kotler (306) also traces the positive demand curve to the Veblen (or snob) effect (328). In this area, others stress such social effects or "conspicuous consumption" aspects of product pricing (143, 479, 584).

Recently, Monroe, Bitta and Downey (366) have explored further the effect of contextual or situational influences on the buyer's price judgements, concluding that the intended use of purchase is important in causing a positive demand curve.

Stafford and Enis (514) have attempted to substantiate Leavitt's contention that the importance of price signalling depended on the costs of gathering other information, and found that price as a quality index was confounded by other information, when it was available.

Shapiro ( 479) sees the individual's reliance on price as a function of factors like trust, snobbery, and risk, claimimg that price reliance was a generalised attribute of some consumers. In related work, Lambert ( 318, 319) and Bettman ( 63 ) developed generalisations to describe those choosing high priced brands in terms of various perceptual, personality and economic variables.

Olson has concluded:

> "that the effects of price cue information are mediated by other informational cues available" (398).

Olson cites as the most prominent cues of this kind brand names, physical product attributes, store image and the consumer's expertise or familiarity with the product type.

This seems to support the contention that price should be viewed as one cue among potentially many, although there is no denial that price is interpreted in a more complex manner than suggested by the simple economic model.

This last conclusion will be of particular relevance here in assessing the economic arguments as to the power of reduced export prices to gain or even hold market share.

Summary

This section has reviewed the contributions of behavioural studies to pricing, in terms firstly of the sources of and variations in price awareness and sensitivity, and then the response of buyers to price as an informational cue in the marketing sense.

In this latter area, much work suggests that price is taken as an indicator of quality, although more recent studies conclude that this is mediated by contextual cues and product and buyer characteristics.

These points are relevant here particularly in the context of assessing the argument that export market shares are determined by relative prices in the same way that this has been done for the more general pricing model.

## 2.1(d) MARKETING THEORY

This section draws attention to the use of price as a marketing variable, as part of the total product offering (478). Many have suggested that price is of low importance to marketing management: Udell (553, 554), Kjaer-Hansen (300), Pass (418), Metwally and Day (358), as compared to other non-price forms of competition, although Gabor claims:

> "The recognition that price is a highly effective marketing tool at all levels is now widely accepted and less and less credence is being given to the formerly popular view according to which price is simply the cost of the product plus a customary fixed percentage of profit." (196)

This may additionally be compared to the recent conclusion reached by the Henley Centre for Forecasting, that:

> "Correct decisions on pricing will usually be the most likely road to successful marketing of consumer goods and services in the next year or so." (344)

Accordingly, some examination of the marketing aspects of price is necessary.

## Price in the Marketing Mix

Taking the marketing programme as an entity, consisting of product policy, price policy, distribution policy and marketing communications, then:

> "it must be recognised that for many consumers a trade-off will arise between price and some other element of the competitive mix" (332).

The implication of this is that while price is accepted as distinct from the other marketing elements (405, 409), the management problem is one of consistency and integration between the elements (314, 332, 339).

This is of particular relevance here in the context of the relationship between price and other forms of competition in exporting, especially under conditions of currency movements.

## Promotional Pricing

There is evidence that short-run price reductions achieve appropriate short-run objectives, but that this may be at the expense of longer term considerations: for example, corporate and brand image erosion (102), increased price awareness and reduced brand loyalty (332), buyer distrurbance from rapid price movements ( 53θ, and increased price consciousness from a high frequency of price promotions (250).

The existence of factors of this kind in the general case leads to a later consideration of their role with export price moves, including those associated with currency movements.

## Pricing in the Product Life Cycle

The implication of the available product life cycle models, for example Wasson (560), is that the role of price may change through the life cycle, as in various sources: (196,306 ,332 ,409 ):

| | |
|---|---|
| Market development | - Matching value perceptions and segmentation by price |
| Rapid growth | - Price lining and promotional pricing |
| Competitive turbulence | - Promotional pricing |
| Saturation/Maturity | - Defensive pricing, search for incremental pricing opportunities |
| Decline | - Maintenance of profit level pricing (560) |

The major implications of this model here are that there may be particular parallels which may be drawn between export and new product pricing, as discussed shortly, and that the application of the life cycle model to the international market is often claimed to show the existence of opportunities for firms to pursue different price strategies in different markets.

Product-Line Pricing

Operational pricing must recognise the interdependence of demand in the multi-product firm (140, 407), around which issue relatively little theory appears to have been developed. This is considered further in Price Management below.

Price Discrimination

Finally, the marketing view of price has to recognise:

> "strategies for extracting additional money from consumers in the face of imperfect information and of implementation costs" (440).

This includes straightforward factors like discounts and the functional role of the customer (140, 333),geographical differentials and nonuniform pricing (440).

In this study the major interest lies in the possibility of discriminating between the domestic and export markets and between different overseas markets.

## 2.1(e) MANAGERIAL THEORIES, METHODS OF PRICING AND EMPIRICAL EVIDENCE

### Managerial Theories

Developments of managerial theories of the firm are significant in evaluating pricing, and are felt by some to be more useful than the simplistic assumptions of the economic model of the firm.

Various writers have noted the impact of management discretion or administrative judgement on prices, for example Alderson ( 8), Burkhart ( 89), Geiss (203), Huegy (258), Knobl (302), and Weston (570), while Wilkes and Harrison point out that the tendency to use cost-plus pricing methods can only be explained by deliberate management choice (575).

The formalisation of these influences is found in the various managerial theories of the firm, where:

> "All the theories are designed to explain the behaviour of large firms where the separation of ownership and control leaves decision making in the hands of salaried professional managers" (417).

This may be traced to early researchers like Papandreau (413), who claimed that the objectives of the organisation were a "general preference function" resulting from the aims of different parts of the organisation. Simon's concept of satisficing rather than maximising behaviour (493) is of particular relevance, leading to the classic Cyert and March model (133), based on organisational goals arising out of the "quasi resolution of conflict" in the "coalition of interests", which are essentially satisficing objectives given sequential attention. Empirical support is offered by Hague and others (228, 229).

In addition to these organisational and behavioural models, some have stressed the maximisation of a management utility function:

> "managements pursue their own self-interest subject to their retaining effective control of the firm" (417).

In this latter category may be included Baumol's sales maximisation ( 60), Williamson's management utility function maximisation (576), and the maximisation of the growth of the firm analysed by Marris (347, 348) and Penrose (427).

The significance here of these approaches is in explaining the existence of non-profit maximising behaviour and thereby admitting the possibility of models which are essentially satisficing for the analysis of export strategy and pricing.

## Managerial Pricing Models

This section attempts to catalogue the pricing methods available to the management price maker. Shapiro and Jackson (478) have recently argued that pricing strategies can be divided into those with a strong internal orientation, based on costs; competitive pricing; and pricing focussing on the customer.

Cost Models - The substance of the cost concept debate has already been examined, and attention drawn to cost-plus and target rate of return pricing models. While refinements to cost-plus methods have been attempted, for example by Brooks ( 81), Hapgood (236) and Seglin (474), the majority of normative writers lean towards marginal or incremental cost models.

One emerging tool of predictive power in this area is experience curves as a planning mechanism ( 74, 75, 361), since if costs decline in a predictable manner with units produced, the firm producing the most units has the alternatives of higher profits or lower prices. This has been tested empirically, for example in chemicals ( 68, 103), and appears of particular relevance to the prediction of market prices on a cost basis.

Competitive Pricing Models - In this area, most recent attention has been devoted to probabalistic models for use in bidding, for example by Green (219), Frederick (185), Walker (559) and Geiss et al (203). Naturally on a broader front, much of what has been said about oligopoly is concerned with the effect of competitors as a price determinant.

Market and Demand Models - It is frequently argued that cost-based pricing is inappropriate and that only market pricing is satisfactory, for example (276, 494).

In terms of specific methods, there are firstly marketing research applications of various kinds.

In early practical work, Dean (140) reported the use of experimentation to set alternative prices, questionnaire surveys of customers, and engineering studies for industrial products.

In the 1960's, Stout (522) reported the developing techniques for measuring price sensitivity and Abrams ( 3) pointed to test marketing and survey techniques available, and described the development of a panel application on a split-ballot basis.

Major developments have been associated with the Nottingham group, from Gabor (196) and Pricing Research Ltd. ( 19). The operational techniques from this source include, firstly, observation methods in normal shopping situations, secondly, survey methods, ranging from simple, direct questions to simulated shop choices, and thirdly the Buy Response technique. This last approach is based on the price limit concept outlined earlier in 2.1(c), with the objective of measuring these limits. The normal practice of the technique involves in-home or hall interviews and attempts to simulate the shop situation, and measures the percentage of respondents willing to buy at each of a range of prices, which is plotted to give a visual Buy Response Curve.

More recently, Jones has reported a survey technique of ranking products on a split-ballot, with different prices in each (277). Wilson (580) has described a technique of customer evaluation of product features, used by Du Pont, to place values on the features for pricing, and Anderton et al ( 13) have applied a sequential analysis approach to price research.

A less systematic, though equally market based and apparently common, approach to pricing is described by Shapiro (480) as "customary prices", which are "prices set by custom, tradition, assumed consumer psychology and other nonobjective means". Gabor (194) has suggested that such approaches are self-perpetuating and lack any real justification.

Another well-known market-oriented technique is Product Analysis Pricing ( 80, 85 , 495), which is based on the development of market derived standard values for the elements of the "product surround". A similar though more recent method developed by Shapiro and Jackson (478) is value utility pricing, involving the placing of a value on each attribute of the product from the customer's point of view, while Palda and Blair (412) have attempted to use production theory for the same purpose.

Since this section is concerned with price making, no further analysis is attempted of price taking in the sense of accepting market prices.

Empirical Pricing Studies

Various surveys conducted at the company level are available.

There are problems in interpreting such work, since as Edwards and Pearce (162, 425) have pointed out, there are differences between claimed and actual practices, and Hague stresses:

> "the fact that pricing begins from cost figures does not mean that it will necessarily be cost-plus pricing." (229)

In the 1950's, Shackle (476) found that the most important pricing methods were full-cost and modified full-cost, although marginal pricing appeared to attract substantial support. Pearce (425) found that executives claimed to use cost-plus pricing, but in terms of actual pricing behaviour:

> "the nearest approach to a general rule of price fixing is simply 'what the traffic will bear'" .

An American study of the same era reached essentially the same conclusion ( 21).

In the early 1960's, Barback ( 43) found that firms did not price according to marginal analysis and emphasised cost-plus approaches. At a similar time in America, Udell (553) found that firms claimed that competitive pricing was the most important method, although closely followed by cost-plus methods and "what the market will bear".

Skinner's 1968 survey (503) found that 70% of firms claimed to use cost-plus pricing, although his evidence suggested that this was often Dean's "variable or flexible mark-up pricing" (140), since firms adjusted prices to take account of competition and demand.

Hague's study of cases (229) emphasised competitive, satisficing pricing.

It has been suggested variously that little use is made of marginal concepts, as far as pricing is concerned: (214, 242, 500, 502).

Most recently, in 1975 Atkin and Skinner ( 28) found that the main pricing method reported was adding a percentage to costs, and that the cost base was most often obtained by absorption costing methods. It was, however, noted that cost-based prices were modified for non-cost considerations.

On the basis of this brief review, it appears reasonable to take Howe's conclusion:

> "from the evidence .... it would appear that although cost conditions exercise a strong influence on pricing decisions, businessmen do take account of demand factors and competition." (257)

This has to be interpreted in the context of the earlier debate in 2.1(a) and the limitations of management surveys noted above. The debate is pursued in comparing export and domestic pricing policies in 3.3(b) below, particularly from the point of view of suggesting that the comparison of these policies may avoid some of the measurement problems in asking for a direct statement of policy.

## 2.2 BUSINESS OBJECTIVES

## INTRODUCTION

Livesey has written that:

> "Any discussion of pricing policies should be set within a framework of business objectives and of the constraints within which firms operate when trying to achieve these objectives." (332)

Similarly, Rogoff and Lynn (454) have attempted to relate pricing methods adopted to the objectives sought. This topic is pursued briefly at this stage in a general way, and then in the more specific export context in 3.1(a) below.

As with the examination of pricing methods, however, some reservations are necessary in interpreting direct research, and Baumol has noted:

> "there is no simple method for determining the goals of the firm or of its executives. One thing, however, is clear very often the last person to ask about the individual's motivation is the person himself .... In fact, it is common experience when interviewing executives to find that they will agree to every plausible goal about which they are asked." ( 59)

This section proceeds by examining the available theories of corporate objectives and empirical evidence, in so far as this has not been covered in the managerial theories of the firm considered earlier.

## 2.2(a) THEORIES OF CORPORATE OBJECTIVES

The economic assumption of a single corporate objective of short-run profit maximisation has been attacked on various bases. Bridge ( 80) notes that business objectives are multiple, changing, and not always consistent with profit. Similarly, Davies and Hughes (136) point to the attack on profit maximisation, largely associated with the divorce of ownership and control and the "managerial revolution".

In attempting to catalogue objectives sought, Hague (229) differentiates between operational and non-operational objectives, where consensus in in organisations seems largely restricted to the non-operational, by way of constraints. Gabor (196) reviews principles of profit maximisation centred on total profit, the mark-up rate, the rate of return on the net worth of the firm, and the total asset value, arguing that the last is the most general and appropriate, although recognising the existence of other aims like target profit, stabilisation of the market, growth, and short-term goals.

As noted above, the development of managerial theories of the firm has concentrated on management objectives, and the recognition of their personal preferences (249). This area has been pursued earlier in terms of satisficing theories and the maximisation of functions other than profit, including sales, growth and managerial utility.

## 2.2(b) EMPIRICAL EVIDENCE ON CORPORATE OBJECTIVES

The classic work by Kaplan et al (287) established that in large companies the objectives given prime importance were: (a) to achieve a target return on investment, (b) to maintain or improve market position and (c) to stabilise prices and margins. Subordinate to these, but still important, were meeting or following competitors and achieving product differentiation.

Similarly, Lanzillotti (322, 323) reported that the most frequently mentioned goal was a target rate of return on investment, which was increasingly used and where the target rate reflected "fairness", tradition and desired stability. The second most common goal found was the stabilising of profit and margins, third was target market share and fourth meeting or preventing competition.

Shackle (476) and Barback ( 43) found that firms considered profit important but also survival and loss avoidance, and rejected the explanatory power of the profit maximisation principle:

> "Profit is obviously important to businessmen, but the degree of importance is not absolute." ( 43)

Hague's more recent case study research (229, 228) found that of thirteen cases, eight firms were satisficers and five were maximisers, although it was felt that maximisation was more likely with price than any other variable, because the impact of decisions was external to the organisation. Hague found that the behaviour of firms was generally compatible with the Cyert and March satisficing model, based on aspiration levels in a number of areas, attended to sequentially, made possible by the existence of organisational slack.

A study of large U.K. companies by Pass (418) divided their pricing objectives into financial and non-financial. The main objectives in the former category were: a target rate of return on investment in the long run, and secondly, the maximisation of profits in the long run. The other category included: sales expansion, maintaining or expanding market share, long run growth, meeting or following competition, and price stabilisation. Those claiming the status of profit maximiser appeared to approximate this operationally by using a target formula with a "maximum possible" profit rate.

This brief review suggests that the objectives pursued, both in the general sense discussed here and in the more specialised area of exporting, will differ in some circumstances from those assumed in the economic analysis and may offer insight into strategy formulation and the export pricing process. This is pursued below.

## 2.3 PRICE MANAGEMENT

# INTRODUCTION

The implication of market imperfection, product differentiation and marketing action is administered or managed prices (248, 403, 405), although there is some debate as to the nature of the role of price in the marketing programme.

It is true that some emphasis is placed on the management of price as a strategic variable: for example, by May (353) because of domestic price controls, by New (386) because of the need to integrate marketing and production strategy, and by Singer (499) because of the need to put pricing into the framework of the long-range financial plan, leading some to see price as an essentially general management problem (135, 388, 536) and to stress the desirability of having an explicit corporate price plan (333, 509).

Accepting that price seems rarely to occupy a neat functional role, this section reviews the major types of price decision faced and the major constraints existing.

## 2.3(a) TYPES OF MANAGEMENT PRICE DECISION

Price decisions are catalogued variously. Dean (140) distinguishes between basic price (primarily new products of different kinds) and the problems of product-line pricing and the use of discounts as a form of discrimination. Field et al (174) make more of the differences between pricing established products (concerned mainly with price changes) and pricing new products.

Recently, Monroe and Bitta (369) have classified pricing models into those associated with new product pricing, product-line pricing, price changes and price structure. This framework is adopted here and developed briefly.

## 2.3(b) NEW PRODUCT PRICING

Monroe and Bitta point out that:

> "New product decisions usually are made with very little information on demand, costs, competition, and other variables that may affect success." (369)

The distinction made here is between the strategies for new product pricing and the approaches to price setting.

The seminal work on new product pricing is, inevitably, Dean's (141, 142) offering the market skimming and market penetration policy choice, which has arguably shaped many of the more recent writings on the subject (174, 257, 273, 462). In the specialist area of this study the penetration and skimming argument is of particular interest, since it may be argued that in export strategy there is a choice of this kind, which has implications for the use competitively of export prices. It will be argued later that the export decision is frequently characterised by the conditions described above by Monroe and Bitta as being associated with new product decisions.

This is illustrated by Howe (257) by an examination of the pricing behaviour of Japanese motorcycle firms in the 1960's, when Honda, Yamaha and Suzuki sold at losses in export markets to gain penetration. This has been related by some to the learning curve concept discussed earlier ( 74, 75 , 137, 361, 520), in favouring aggressive, volume-oriented new product pricing.

In terms of actual price setting, some emphasise traditional sequential models (369):

| Step | Dean (141) | Oxenfeldt (405) | Welsh (568) |
|---|---|---|---|
| 1 | Estimate demand | Select market target | Estimate demand |
| 2 | Select market targets | Choose brand image | Determine marketing requirements over product's life cycle |
| 3 | Design promotional strategy | Compose marketing mix | Plot product's expected life cycle |
| 4 | Choose distribution channels | Select a pricing policy | Estimate costs over product's life cycle |
| 5 | | Determine a pricing strategy | Estimate competitors' entry capabilities |
| 6 | | Select a specific price | Estimate competitors' probable entry dates |
| 7 | | | Select a specific price |

This matches the type of multiple constraint approach found by Thompson and MacDonald (534a), where firms grouped factors influencing new product prices into: profit and cost considerations, competitive considerations, product factors and market or sales expectations. It is also compatible with the Wilkes and Harrison warning on the dangerous consequences possible with purely cost-based pricing for new products (575).

The Nottingham approach to new product pricing, based on the Buy Response concept, was discussed earlier.

Others have attempted various models of new product pricing (369, 474), though apparently largely inhibited in practice by the limitations on information available.

## 2.3(c) PRODUCT-LINE PRICING

It is inherent in the multi-product firm that demand and cost interrelationships in a product-line make the pricing decision more complex. Livesey (332) lists the problems as relating to the substitutability of products, consistency, market coverage, complementary demand and the use of joint facilities. Dean (140) emphasises the importance of product-line pricing as an instrument for market segmentation and price discrimination. Others, like Buckley ( 86) and Day (139) stress the product portfolio approach to managing groups of products, in the sense of balancing their cash and profit producing capabilities and their future propects.

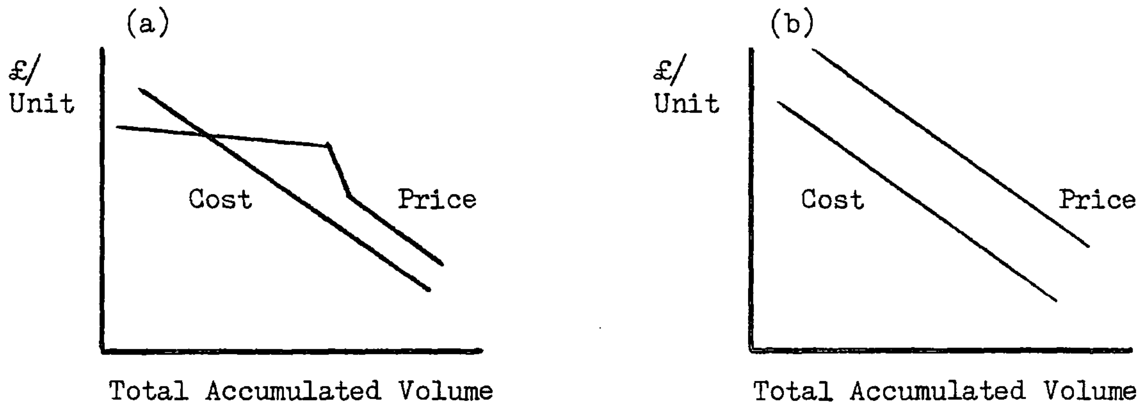
In operational terms, it seems that relatively little general theory exists to assist the decision maker. Oxenfeldt (408) has stressed the marketing interrelationships, and Urban (556) and Hess (247) have been among those attempting to model these.

Here it is accepted that the product-line issue exists as an important constraint on price decisions, but it is suggested that apart from minor differences, no distinction is necessary for the purposes of this study between product-line pricing issues for the domestic and export markets (assuming that the same product mix is offered to both types of market).

## 2.3(d) PRICE CHANGES

Economists argue that administered prices and oligopolistic markets lead to price rigidity (see 2.1(a) above), to which pressures may be added domestic price controls and depressed markets (253, 353) leading to fewer price changes. Arnold ( 23) argues that it is cheaper to adjust output than price, and Cubbin (129) found that product quality changes seemed a favoured way of changing (particularly decreasing) quality-adjusted prices. However, attention may be given to price changes associated with maturing products and temporary price changes in the form of sales promotion.

The changing role of price in the product life cycle has been discussed as a marketing theory (in 2.1(d) above). The emerging theory here is that learning curves provide a predictor of price trends, as a tool for planning prices at the firm level. The Boston Consulting Group work ( 74, 75) suggests that price curves fall into one of two main categories, as illustrated below.




Most price curves were found to correspond to (a) and some with (b), and it was found that prices tended to behave in a remarkably predictable and regular manner. Davis (137) develops from this a prescription of aggressive price-cutting as long as market growth continues.

The use of price cuts as a temporary measure for promoting sales is associated primarily with tactical aims (332) and may involve risks to long term marketing objectives, as outlined earlier (250). This point is developed shortly in the context of the use of export prices.

## 2.3(e) PRICE STRUCTURE

The develoment of price structure is associated by Monroe and Bitta (369) with determining the time and conditions of payment, the discounts to be given, and where and when title is to be taken to goods by the purchaser.

The first and last of these are considered for exporting in 3.2(a) below in the examination of the terms and conditions of international trade contracts.

The issue of discounting and other forms of price discrimination (128, 140, 332), is associated in this study mainly with the discrimination by price between the domestic and export markets and between different geographic export markets. This topic is developed in 3.3(a) below.

## 2.3(f) CONSTRAINTS ON PRICE

Much of what has been said about market structures, demand and competition amounts to a description of the constraints on pricing freedom from the decision maker's point of view. Clearly, a complete analysis of all other possible constraints is not possible here, but it is necessary briefly to recognise the existence of some of the major limiting factors.

Mallen (339) points to the impact of manufacturer pricing decisions on distributors, and it will be seen later that this is of particular significance in export pricing.

Guiltinan(225) has argued that the economic uncertainty of modern markets has led to "risk-aversive pricing policies", in terms of such things as delaying quotations, escalation clauses, and "unbundling" services from products. It will be seen that this has important implications for export strategies in terms of such factors as the exporter's reaction to currency changes and the balance between price and non-price aspects of international competition.

Probably the greatest area of constraint lies in government and legal controls over pricing, aimed at such objectives as stabilising price levels, controlling monopoly power, consumer protection (108, 136, 362) and even the protection of established businesses (444), and including both formal, statutory controls and bodies, and less formal pressures. This has significance here particularly in comparing pricing actions in the domestic and export markets.

It is noteworthy that the Treaty of Rome provides for control of price fixing arrangements and other trust conditions, particularly price discrimination and its enforcement through parallel pricing. This will be significant to assessing the real choices open in export price strategy.

# CHAPTER 3

## EXPORT MANAGEMENT

## 3.1 EXPORT MARKETING

## INTRODUCTION

The purpose of this section is to provide the export marketing context for pricing decisions, to be followed by a review of the relevant financial considerations in export.

The underlying objective is to study the decisions and operating characteristics of export marketing in a way which leads to the development of hypotheses attempting to explain the use of the price variable, in the total export strategy pursued.

The first area considered is that of the development of export activities in the firm, particularly in terms of the motivation and the objectives associated with export.

The second topic is export strategy, that is the means available to reach the chosen objectives, together with the special constraints existing in exporting.

Thirdly, there is the issue of market selection, and then the general question of international competitiveness, which is of particular importance here in the context of the debate about the relative use and importance of price and non-price competition.

Finally, there is the question of the profitability of exports, which is relevant as a measure of the outcome of the strategic and competitive issues discussed and the export pricing decision on which interest is centred.

## 3.1(a) MOTIVATIONS AND OBJECTIVES IN EXPORTING

### Exporting and International Marketing

Firstly, there is a need to clarify briefly the meaning attributed to export in the firm's develoment, and to distinguish this from domestic and international business.

It is common to a number of sources that the move from domestic market business towards exporting is seen as a development involving stages or incremental steps.

Tookey (540) argues that a distinction should be recognised between exporting, international marketing and international business. Tookey's argument was that exporting aimed to dispose of surplus production anywhere in the world at the minimum expenditure, tending to use home market intermediaries. International marketing, in Tookey's model, involves maximising sales in world markets, investigating and distinguishing markets and using overseas agents and subsidiaries. International business aimed at maximising returns throughout the world, often through direct investment. Tookey concluded:

> "as the firm progresses from exporting to international marketing to international business, the objectives, policies and organisation are adapted to new opportunities and their exploitation." (540)

A similar continuum view is expressed by Wind et al (582), whose model distinguishes between: ethnocentrism, or home market orientation; polycentrism, or host country orientation; regiocentrism, or regional orientation; and geocentrism, or world orientation. The case made by these writers is that marketing strategies should differ under each orientation.

It seems wholly unremarkable to define exporting as selling goods to foreign markets, but there is some difficulty in distinguishing between export and international marketing.

One view which appears useful is Kotler's (307). Kotler sees export as marketing to overseas buyers, indirectly through independent intermediaries, based domestically or overseas, or directly by contacts with purchasers overseas. This may involve the use of a domestic export department, an overseas sales branch, a subsidiary or a distributor. This concept of export is distinguished from joint venturing of various kinds, direct investment in manufacturing, or full multinational marketing through:

> "developing a worldwide network of production facilities and serving a plurality of markets through a global marketing strategy." (307)

In this context it seems justifiable to take export as selling overseas, without direct investment in overseas production, as in Kotler's approach, although also accepting Tookey's point that when the stage is reached of establishing an overseas subsidiary company, this is effectively international marketing rather than simple export, even though that subsidiary is a marketing rather than production unit. This combined definition of export is that used in the primary research reported later.

Lastly on this point, attempts have been made by Meidan (356) to differentiate between export marketing management and export management, in terms of the differences between marketing and sales orientation. This may be of relevance later in helping the analysis of the stages of development in the export function in the business.

This debate, however, leaves untouched the question of the difference between the terms export marketing and marketing, both in theoretical and organisational contexts.

Recently, Tookey has claimed that:

> "Export marketing uses the same concepts and techniques as home marketing. But it is a variation at a higher level of development" (538)

It may be that challenges could be posed to this contention on the grounds of both lack of evidence of theoretical development and sophisticated practice, and this will emerge in the hypotheses developed in this study. It appears relevant to note the additional curiousness of Tookey's view, bearing in mind his earlier, narrow definition of export as the stage of disposing of surplus production overseas.

A similar view to Tookey's was expressed in the pioneering P.E.P. report, suggesting that:

> "exporting is merely a special case of marketing" (428).

Certainly, there is recent evidence that exporting appears to hold a low level of importance in British companies, in terms of the overt measurable factors of manpower and specialised management ( 62 , 264 , 271 ), and Suntook (524) claims that export is not taken seriously as a function in its own right.

It is, of course, true that descriptive research of the type cited above may not reflect an undesirable situation, since there may be difficulty in distinguishing between the integration of export into the marketing programme and a low emphasis on exporting, since both could be evidenced by a lack of separate attention and formal organisation. Further, it may be that the real impetus is more dependent on the informal organisation and entrepreneurial drive, in the way claimed by Thomas (534), than it is on formal organisation. Similarly, Prasad (436) has studied successful U.S. exporters and reports that in the cases studied export was an integral part of the corporate marketing function. Additionally, it might be noted that Wills has attempted:

> "to demonstrate the essential need of integrating company export marketing within the total marketing operation." (577)

It would, however, seem that recent empirical comparisons between the U.K. and overseas exporters suggest a shortfall in the relative efforts and manpower devoted to exporting, as, for example, in: the BETRO report ( 62), Tessler's recent paper (533), the I.M.R. report "How British and German Industry Exports" (264), and the Barclays Bank report (271).

This last point of integration compared to separatism has certain theoretical perspectives which may be recognised briefly.

<u>International and Export Marketing Theory</u>

Arising out of the immediately preceding points, there is the familiar problem of whether export or international marketing is a separate field of enquiry, or whether it is essentially part of the marketing field, perhaps at a "higher level of development" (538).

Ryans and Woudenberg have noted that:

> "Much of the writing in international marketing has simply been neither empirical nor conceptual. Rather it has tended to be descriptive, anecdotal and sometimes problem-solving in nature .... it must be remembered that international marketing has only recently outgrown its 'foreign trade' and 'how to export orientation'." (461)

If this is accepted in the context of international marketing, then it follows that the conclusion is at least as true for the export sector.

However, dissatisfaction with the state of theory does not appear to explicitly answer the question of whether it is necessary to adopt a different approach to the export and international field.

It may even be that this is essentially a European problem, or at least a non-American problem, noting for example, Blank and Greene's finding that:

> "Compared with many British, Swiss, Dutch and even German firms, levels of international interest shown by American companies - whether in exporting or in overseas investment - are frequently low." (70)

Similar points have been made by Crawford (127) with some evidence of greater emphasis on domestic marketing by U.S. firms.

The viewpoint adopted here reflects Bartels' claims that marketing technology has universal validity and applicability, while accepting that the determining, surrounding influences on marketing will vary greatly between environments. This is justified in more practical terms by work like Cunningham and Spigel's study of successful exporters who emphasise the role of exporting as part of the total marketing effort (130).

However, the qualifications expressed regarding the international marketing environment and the specific problems faced in export decisions (which it seems may well be perceived as distinct from domestic market decisions) justify the examination in this paper of general surrounding issues as they affect the export price decision. This does not detract from any perceived need to see exporting as part of the total corporate marketing effort.

## The Export Decision and the Development of Export in the Firm

There may well be a case for distinguishing shortly between firms in terms of their commitment to exporting and the way in which export was initiated, as determinants of policy. This section attempts a review of what is known about the decision by firms to export, or at least the reaction by firms to external stimuli, which brings about exporting.

Various writers have attempted descriptive models of the development of export activity in firms, seeing this as: a sequence of stages [Bilkey ( 66), Bilkey and Tesar ( 67)]; a process of internationalisation [Johanson and Vahine (275)]; a form or aspect of innovation [Simmonds and Smith (491), Lee and Brasch (326)]; and an unsystematic response to external stimuli, commonly in the form of unsolicited orders from abroad [Simpson and Kujawa (497), Arpan ( 24), Day (138), Wiedersheim-Paul et al (572)].

The conclusion reached by the Bilkey and Bilkey and Tesar papers ( 66, 67) is that export is essentially a developmental process in the form of a learning sequence or stages. Their model may be summarised:

<u>Stage 1</u> Management is not interested in export and would not even fill an unsolicited order.

<u>Stage 2</u> Management is willing to fill unsolicited orders, but makes no effort to explore the feasibility of active exporting.

<u>Stage 3</u> Management actively explores the feasibility of exporting.

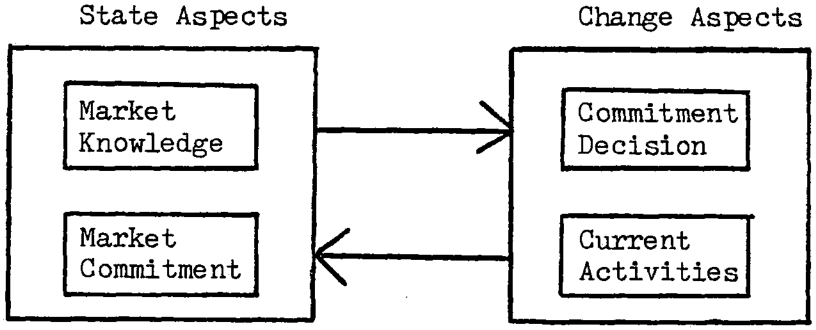
<u>Stage 4</u> The firm exports experimentally to some psychologically close country.

<u>Stage 5</u> The firm is an experienced exporter to that country.

<u>Stage 6</u> Management explores the feasibility of exporting to additional countries, psychologically more distant.

The important implication of this model for present purposes is that the determinants of behaviour, and thus the policies likely to be adopted, differ from one stage to another.

In a similar way, Swedish research (275) also concludes that the internationalisation of the firm is a product of a series of incremental decisions, involving the gradual acquisition, integration and use of knowledge about foreign markets and operations, and an increasing commitment to foreign markets. This model distinguishes between state and change characteristics, as shown below.



The change aspects of this model may be compared to the innovation models produced by others. The early Simmonds and Smith research (491) studied small firms gaining their first export orders and concluded that much of the innovation could be traced to factors outside the firm, although within the firm the innovator's degree of "enterprise" and travel appeared to correlate with innovatory behaviour. More recently Lee and Brasch (326) adopted a similar approach and found that starting exporting through innovation traceable to outside agents was more common than a problem-oriented adoption process. They had to reject the hypothesis that export adopting firms followed a rational adoption process (where rationality was defined by the investigators as goal directed and considering various alternatives), since it appeared that the majority were not rational in terms of this specification. It was suggested in this latter study that "rational" and "irrational" and "problem-oriented" and "innovation-oriented" companies tended to differ in firm characteristics and particularly in their perception of the environment.

The reactive aspect in internationalisation is emphasised by others. Simpson and Kujawa (497) challenge the assumption that the exporter can be profiled as rational, economic man (in the context of responding to government export incentives). They found that in a sample of small and medium sized exporters, companies did not systematically originate investigations of foreign markets and that exporting was commonly the result of fortuitous circumstances, frequently the arrival of unsolicited orders. It also seemed that the perception of profit, risk and cost differed significantly between exporters and non-exporters. In a similar way, Day (138) has pointed out that the decision to export may be largely involuntary, if unsolicited orders arrive. Certainly, this appears compatible with McFarlene's recent findings (378) that successful Scottish exporters frequently held negative attitudes towards exporting and the desirability of export growth, and many saw exporting as a "necessary evil".

In a related way, Arpan ( 24) in distinguishing between exporting and international marketing notes:

> "The exporter may sell simply because of excess capacity reasons, because a nondomestic buyer has run short and needs an emergency purchase, or for a number of similar, less planned occurrences."

Robinson (451) also distinguished export from domestic business as less likely stimulated by internal company sources and more because of external pressures.

This may go some of the way, as suggested earlier, towards explaining the lack of response to export promotion and incentives noted by Forbes (176), Mackay (337) and others.

An approach by Wiedersheim-Paul, Olson and Welch (572) presents a model of internationalisation of the firm, which stresses pre-export activities, and especially the characteristics of the decision maker, the domestic environment, the extraregional expansion of the firm, and "triggering cues" or "attention-evoking" factors, which include internal factors like unique competences and excess capacity, and external factors like fortuitous orders from abroad. In this model firms are categorised as active or passive or domestic on each factor.

The common elements in these approaches are, firstly, that the move towards internationalisation may involve a number of stages in which firms behave differently, secondly, that frequently the initiation and pursuit of export business appears to be essentially reactive rather than active, and thirdly, that in the reaction there may be distinguishing characteristics of firms and managers which determine the responses.

The importance of these findings to this study lies in their implications for the strategies pursued in different situations and particularly the pricing problem, especially in re-assessing the real value of prescriptive, generalised theories in exporting.

Further insights may be gained by studying what is known about the objectives pursued and recognised in export, and what is known about influences on the firm's propensity to export.

<u>Export Objectives</u>

Firstly, it is necessary to recognise the explicit, deliberate objectives in exporting, before considering exporting as the recation to various change agents.

Day (138) points out that there are various corporate advantages served by exporting, in terms of entering a larger market than the domestic, with the possibility of more rapid market growth and overcoming seasonality, and reducing the risks associated with dependence on a single market. Similarly, Tookey (538) sees this as a process of matching resources with opportunities abroad.

At a more analytical level, Hague et al (227) distinguish between anti-cyclical exporters, who only emphasise export when home markets are depressed, and regular exporters who use export to attain growth.

The interest here in such a distinction, which will be pursued shortly, is in the implication that firms seeking different overall aims from export may adopt quite different policies, both in general strategy and in the pricing area.

Hague found in his study that over and above this general motivation and use of exporting, the great majority of firms had objectives to increase export volume, rather than profitability, although commonly these volume objectives were subject to a profit constraint. There was also evidence of what Hague regarded as non-operational objectives, in such areas as stabilising prices, initiating "patriotic" price cuts and the like.

These findings appear largely compatible with Tookey's earlier paper (540), which related objectives to the development from export to international business. He saw the export stage as concerned primarily with the disposal of surplus production volume, while in international marketing there was an objective of maximising sales in world markets. Bearing in mind the rejection in this study of a clear-cut distinction in Tookey's terms between export and international marketing, there is the suggestion of volume orientation which cannot be ignored.

Bilkey (66) points out that in the case of firms deliberatly initiating export, rather than reacting to change agents, findings are mixed regarding the objectives sought. Hunt et al (260) found that short-term profit was not the motive in exporting, suggesting that long-term profitability through market diversification and growth was more common. This was also found by Cooper et al (117). Other studies concur that export is thought to add little to short-term profit, for example: Tookey (539), Barnhart (50) and Sinai (498). Similarly, the BETRO report (62) notes that it appeared that volume not profitability was decisive in market choice.

In contrast, Simpson (496) found that in a sample of firms, exporting was regarded as a means of gaining high profits. Bilkey suggests that such differences may reflect changing economic conditions. This may offer some explanation for the recent Barclays Bank report (271) finding that for British companies the main objective of export business was seen to be increasing profit, rather than volume, with some mention of such aims as stimulating research and gaining prestige, and avoiding fluctuations in the home market.

Earlier U.K. research evidence was provided by the P.E.P. report "Attitudes in British Management" (428), which found that export objectives were mainly economic, particularly seeking greater volume and less competition, but also noted non-economic reasons like tradition and government persuasion.

It would seem then that in the area of explicit export objectives, great emphasis has been placed on volume objectives, with some mention of non-operational considerations, although recent evidence suggests that, at least for the U.K., there may be an emphasis on profitability, which may reflect changing economic conditions, perhaps most importantly the effect of currency floatation on Sterling.

Secondly, there is the issue of firms exporting largely as the result of change agents, and what is sought through these responses to outside stimuli, together, by implication, with the evidence on what influences their propensity to export.

Many factors have been proposed as influencing the propensity to export in firms. It has been claimed, for example, that company size is a critical factor: Hunt et al (260) found that smaller firms in U.K. engineering tended to take a passive attitude towards exporting and to lack objectives.

Bilkey ( 66) points out that while many see size as an important factor, the empirical evidence is mixed. While writers like Hackett (226) claim that larger firms have a greater tendency to export, recently Abdel-Malek ( 1) has found small firms to be similar to large firms in terms of export-orientation and involvement.

It has often been pointed out that the propensity to export is a function of the relative demand faced in overseas and home markets. Hague et al (227) considered that firms facing rapid growth in the home market tended to have less coherent export policies (although still exporting, since in the cases studied overseas markets were also growing rapidly). This may be compared to the more extensive Cooper, Hartley and Harvey study (117), which concluded that U.K. exports responded only slowly to overseas demand changes, and that there was little consistency in the effect of the pressure of domestic demand, leading them to a general belief that exports were not significantly affected by the level of domestic demand. This was also found in the earlier study by Hunt et al (260). It has to be noted, however, that others like Kizilbash and Milne (299) claim that there is evidence that export efforts are influenced directly by economic conditions.

If the general point is accepted that the environment will have at least some determining influence on the firm's reaction to opportunities, although this may not be obvious, then equally there seems to be a need to look to factors inside the firm as determinants of response to stimuli provided by a given environment. This may be justified in the light of the earlier discussion of the managerial theories of the firm.

Bilkey ( 66) has pointed out that non-exporters seem to perceive more obstacles to exporting than do exporters, along the lines shown by Weekly and Bardi (562), grouped primarily around market conditions, channels and finance. In a more general way, the Bilkey and Tesar study ( 67) claimed that progression through the internationalisation process was mainly a function of management quality and dynamism, and their images and perceptions of exporting.

In a recent U.K. study, Thomas (534) points out that all the cases studied of successful exporting shared the common characteristic of management commitment and involvement, which is an argument echoed by many of the prescriptive writers and commentators.

Here, the interest in attitude is in the obvious sense that differences in attitudes and objectives may have some power in explaining and predicting differences in policies and their effectiveness, most particularly in the formulation of export strategy, the pricing policy within that strategy, and the reactions to exchange rate changes.

## Research Objectives and the Hypotheses to be Tested

### Objective 1: Export Objectives

The first aim here is to compare the objectives pursued by management in export and domestic markets.

From the preceding argument, it seems that export marketing may be differentiated from domestic and international marketing, both in organisation and in its objectives. If the development of export is an incremental process of some kind, then it seems likely that export objectives may differ substantially between firms, and indeed within a firm at different times. Here, differentiation is made between active, explicit export objectives and passive, reactive, possibly implicit objectives.

While it is recognised that direct questioning on corporate objectives may be of limited validity, as discussed in 2.1(f) in particular, this is justified here on the grounds that the difference between aims in domestic and export markets may be reflected in the stated, recognised objectives, even if such statements are not fully valid measurements of the full range of objectives pursued by managers.

In this research, the question of export objectives is pursued as one way of building a picture of the local rationality and logic which may be used to explain actions taken in export strategy, particularly regarding market choice and pricing decisions, in terms of a situational approach.

### Hypotheses

1(a) That exporters may be classified into active exporters, with a major commitment to export, and reactive exporters, who respond to outside stimuli and short-term volume needs.

1(b) That export and domestic marketing involve the pursuit of different objectives.

1(c) That export objectives tend to be volume oriented.

1(d) That domestic market objectives tend to be profit oriented.

## 3.1(b) EXPORT STRATEGY

This section sets out to review, firstly, the concept of risk in exporting, and then the general components of export strategy, and thirdly, to concentrate on those issues which are most central to the export pricing problem. The structure involves a review of export marketing methods and their adaptation to export markets, and then a more detailed examination of the market concentration, information and buyer perception issues, since these are to be developed towards primary research objectives.

### Export Risks

While most business decisions are characterised by uncertainty and risk, it is frequently claimed that export decisions are particularly influenced by high perceived levels of risk. For example, Robinson's classic work identifies additional risk in international operations because they involve managing:

> "1. within different national sovereignties;
> 2. under widely disparate economic conditions;
> 3. with people living within different value systems and institutions;
> 4. as part of an industrial revolution set in the contemporary world;
> 5. often over greater geographical distance;
> 6. in national markets varying greatly in population and area." (451)

Some authorities, like Bilkey ( 66), Tookey (538) and Day (138), point to exporting reducing the risks of single market dependence, as an obvious counter-argument.

On the other hand, at perhaps a more analytical level, there appears need for concern with how perceived risk may influence the value system through which decisions are made.

If it is accepted (for the moment intuitively) that the perception of risk is related to uncertainty caused by a lack of information, then it may be that exporting is characterised by high perceived risk, and that this may be a determinant of not simply the export decision itself, but of the export methods used and the general strategy of exporting pursued.

Certainly, it is true that risks specific to exporting have been catalogued by various writers.

Gehrmann et al (202) have pointed to such export risks as increased competition, exchange rate changes, credit and payment problems and the typically long completion time. Lethbridge and Tylee (331) divide these into three groups. Firstly, they point to overseas trading risks, associated with political considerations, credit problems, lack of information and differing market requirements; secondly, contract duration risks, in view simply of the length of time of contractual commitment; and thirdly, shifting exchange rate risks.

It will be seen shortly that there is some suggestion that the perception of export risk differs between exporters and non-exporters ( 66, 497).

The thesis to be put here is that perceived risk changes the decision process in exporting in such a way that apparently desirable or rational courses of action are not taken. This is to be pursued particularly in the context of the availability of marketing information, the strategic choice of market numbers to serve, and later the reactions to devaluation and floatation in export pricing.

## Export Marketing Programmes

The strategic issues considered here are firstly, the export marketing mix, and secondly, some of the determinants of strategic choice and views on the key strategic marketing aspects of exporting.

The position adopted here is that the nature of the elements of the marketing mix remains the same regardless of the market, but that the use of the elements is likely to differ widely according to the type of firm, its resources, the characteristics of the products sold, the nature of the market and buying processes involved, and the influence of various surrounding constraints.

It may be argued that, for example, the same channel decisions are involved, even though in the export market the channel is likely to be longer and perhaps more likely to involve indirect representation, than would be the case in the domestic market. The point of interest would seem to be that the nature of the decision making process may alter the choices made, as compared to the home market.

If this viewpoint is accepted, at least for present purposes, then the most interesting issues become the debate as to the most potent aspects of the marketing programme in exporting, and the degree of adaptation to markets which is pursued.

Key Marketing Factors in Exporting

Various indications are available of the aspects of the marketing mix which are given greatest emphasis, and which are claimed to be the most important in marketing goods abroad.

It may be noted to begin with that there is a growing argument that non-price aspects of strategy in general are more powerful than price competition, in terms of gaining and retaining market share, as advanced by the recent N.E.D.O. report (383). This general argument is pursued in detail in 3.1(a) below.

Within the non-price competition field, various claims have been made as to the relative importance of different aspects of competition. Cunningham and Spigel (130) found that Queen's Award winners claimed that the most important factors in their success were personal visits to markets by company executives, and establishing overseas distribution, although in retrospect most companies emphasised product design and quality.

More recently, in studying Scottish Queen's Award winners, McFarlene (378) found that firms emphasised the importance of product quality and price, and placed a low rating on services, image and other factors. Within the group studied, price was put second in importance overall, although it was rated higher by capital goods manufacturers than consumer goods firms.

The IMR work compiled in 1978 (263, 264, 265, 524) suggested that U.K. exporters considered that the key factors were product quality, price and delivery, with other factors like promotion, credit, reputation, and language seen as peripheral and less important. This appeared to be a view shared broadly by German exporters as well.

There seems then predictably general agreement on the importance of the product and its quality, although less consensus on the other, less tangible, aspects of the marketing programme. This finding may be relevant to the consideration below of international competitiveness and later the impact of overseas buyers' perceptions of imported products.

Adaptation to Export Markets

The issue of the degree and type of adaptation to export markets is related both to the discussion of key marketing factors above and the immediately following question of the number of markets to be served, and is arguably one of the most fundamental strategic issues facing the export decision maker.

Certainly, the adaptation issue is popular among the widely published prescriptive writers, for example, Tookey (539), and Day (138). Similarly, Kothari (305) claims that a "country orientation" is as important as customer orientation, and Ricks et al (447) point to "international business blunders" associated with the failure to change product and marketing practices in dealing with foreign markets.

Another popular argument is that the product life cycle offers a lever for discriminating between markets, as for example advanced by de la Torre (541), with the central prescription that the different product life cycle stages reached in different country markets should be used to adapt marketing policies by country, in what Wind et al (582) have described as polycentric marketing strategies. This is seen as an argument against a single, world-wide marketing policy, although it should be noted that recently Giddy (204) has claimed that the product life cycle is no more than one of many determining factors and that it has limited explanatory power.

In a similar way, Boddewyn and Hansen ( 71) have validated Terpstra's earlier work on American firms' adaptation to the European marketplace (531), and describe the advantages of adaptation to foreign markets, while recognising that standardisation in policies remains preferred by companies on the grounds of the promise of lower administrative costs and a "simple life" for management. Boddewyn and Hansen ( 71) note that the range of adaptation can vary widely, since standardisation does not necessarily blanket all aspects of marketing. Picard's finding (431) that promotional decisions and pricing decisions in international firms tend to differ between markets more than do product decisions, provides some confirmation of this.

In many ways, this argument appears directly comparable with the more general consideration of segmentation strategy by Kotler (307). Thus, the single, world-wide policy equates with Kotler's undifferentiated strategy, and the adaptation to local conditions with Kotler's differentiated strategies. The significance of this comparison is to bring into play Kotler's argument that either policy offers some advantages in different situations, which are differentiated by such factors as company, market and competitive characteristics, and in some cases by the stage of the product life cycle.

It may be that empirical findings like McFarlene's (378) and Hunt's (259) that firms are reluctant to modify products or marketing to meet local conditions, may in some cases represent conditions which favour an undifferentiated strategy, rather than simply poor decisions by exporters. In other words, there may be a situational or local logic which does not conform with generalised prescriptions.

The question of adaptation, and indeed the existence of the type of factors mentioned above, is linked particularly to the strategic issues considered next: the number of markets served and the availability of marketing information in exporting, since these may provide clear constraints on the practical ability to adapt, and perhaps the desirability of doing so.

## The Number of Export Markets to be Served

There appears to be considerable attention in the prescriptive literature directed towards the question of the number of export markets to be served by the individual exporter. Broadly, the prevailing wisdom appears to favour a policy of concentrating efforts on a limited number of markets. This section of the paper devotes some attention to this issue, since it is to be central to the hypotheses developed regarding export pricing. The procedure adopted is to define market concentration of the type advocated in the literature, and its claimed advantages, to examine the alternative, called here market spreading, and then to study the evidence available about industrial practices.

To begin with, there is the question of what is meant by a market in this context. There appears to be a tendency to equate a separate market with a separate country, which tends to ignore the strong case which may be made for ignoring political boundaries in analysing export markets, other than perhaps in the technical aspects of physically moving goods across frontiers. There could be some debate, for example, as to whether Scandinavia should be seen as a single market or three or four separate markets reflecting country boundaries. Further, there is the question of whether a product-market might be seen as European, including all the segments from a number of countries as a single entity, or whether it should be seen as ten or more markets.

Clearly, the judgement reached on this point will be central to assessing the real degree of concentration pursued by a firm. For present purposes the prevailing approach of seeing country markets separately is followed, although with severe reservations as to its validity, on which further comment will be necessary in the course of the discussion.

The definition of the market concentration or key market concept may be taken from various sources, together with the basis for its prescription.

The BETRO report made a statement of some significance here, as an outcome of its objective to answer the question:

> "Would British exports grow faster if companies concentrated upon a few carefully selected countries, instead of dissipating their efforts over hundreds of markets ?" ( 62 )

The logic behind this objective rested largely on the claim that:

> "German exporting companies .... are so successful precisely because they select a few really worthwhile markets for concentrated attention and then attempt to capture a substantial market share in a few areas." ( 62 )

Similarly, the Barclays Bank report suggests that concentration is:

> "defined as purposeful selection of relatively few markets for more intensive development" (271 ).

On the basis of the intuitively appealing notion of "reinforcing success", the BETRO report reaches various conclusions. In the area of market concentration these may be summarised as being firstly, that many British firms sell to too many markets; secondly, that almost all firms would benefit from concentrating their efforts on their best five or six markets; and thirdly, that a new exporter could build up a prosperous trade by delaing with only five or six countries.

Various arguments are put forward to enumerate the benefits of this concentration, in terms of such factors as: limiting the resources required to establish export business; a limited span of control; greater market knowledge, to attain greater effectiveness; and more manpower specialisation, with the implication of greater efficiency and productivity.

More specifically, the argument advanced has it that there are five main categories of advantage stemming from the concentration of export efforts on to a limited number of markets.

Firstly, it is anticipated that there will be less administration; secondly, better market and agent knowledge; thirdly, more opportunity to compete advantageously on non-price factors rather than relying on price competition; fourthly, that there should be less distraction from important tasks because of small markets and small orders; and finally, that sales should be higher because of better quality selling bringing higher market shares.

Clearly this approach is based on a large number of underlying assumptions, both about the criteria for directing efforts, the management resources and abilities in exporting firms, and about the cause and effect relationship between marketing and management efforts and sales and market results. Some of these limitations are explored below.

The concentration approach has been widely adopted by prescriptive writers, for example by Day (138), Tookey (538), Midland Bank advice to new exporters (359), Wilson and Lockhart in advising small firms (579), Hague et al (227) and others, and interestingly is to be found in the much earlier work of Robinson

> "Logically .... a policy of exerting equal energy in developing each national market is obviously not possible. Stripped to its essence, the decision then is to determine which market the firm should concentrate on," (451).

In a later comment on the BETRO report, the author, Tessler says that:

> "The key market study does not tell anybody what to do .... It is merely an attempt to provide facts to induce people to make constructive comparisons." (533)

In spite of this comment, in the same paper, when considering the factors limiting exports, Tessler observes:

> "there is overwhelming evidence that British companies tend to trade with far too many markets .... It means that it is impossible to acquire adequate knowledge in order to deal with markets competently .... it is impossible .... to ensure that the agent does what you want him to do." (533)

It would seem reasonable to see a normative implication here, which goes a great deal further than simply providing a framework to make comparisons, particularly in the light of the more recent Barclays Bank report, also authored by Tessler, which notes:

> "There is evidence to show that companies which made the most impressive progress in their exports usually adopted a distinct policy of concentration upon ten or twelve promising areas and deployed most of their management talent and resources there." (271)

It is far from easy to judge the degree of correlation between concentration and high levels of performance from Tessler's various pieces of work, even if some agreement is implied as to the appropriate criteria to apply to export performance from the point of view of the exporting firm. It is noteworthy, for example in Tessler's Barclays Bank report (271) only one-fifth of German exporters found export more profitable than the home market, compared to 60% of U.K. exporters, in spite of the claimed advantages of market concentration.

This point is not pursued here, since the even more serious flaw in logic lies in the implicit assumptions: firstly, that any such correlation between concentration and performance measures any degree of causality in the stated direction, and secondly, that the correlation or implied causality has a general application for all firms in a universal fashion, regardless of the circumstances in which they trade. This line of analysis is pursued further shortly.

It is perhaps valid to note that this prescription and evidence emanates largely from the one source, although as noted, the concentration principle is approved by others.

By implication, the alternative strategy of not concentrating on a limited number of key markets exists, and for present purposes may be called market spreading, which unlike the defined concentration, may or may not be purposeful.

There are advantages which may be associated with market spreading, in spite of the arguments by Tessler and others to the contrary. To begin with, McFarlene (378) claims that exporters work with little or no information, and they:

> "generally approached exporting as being a 'necessary evil' preferring if possible to concentrate on the home market,".

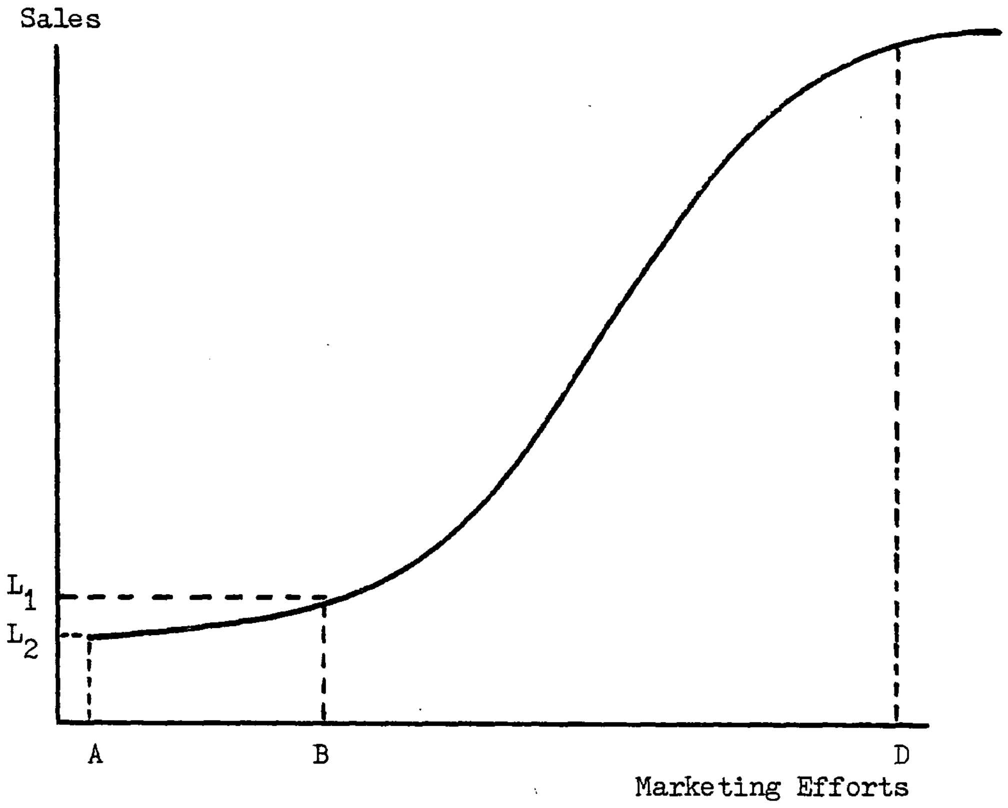
If this is the case, it seems unlikely that the main source of business for firms of this kind is likely to be represented by a series of high market shares in a limited number of carefully selected markets. If the reality of the marketplace is that exporters pursue apparently haphazard, "hit or miss" tactics, then it may be as well that they do not restrict the number of markets served. To claim that they should not pursue such tactics is a separate argument, which involves many other issues, and does rather beg the question of why firms in such circumstances should pursue a concentration strategy.

The rationality of such approaches is perhaps best judged in the context of the earlier analysis of the export decision in 3.1(a) above and of corporate objectives in 2.2 above. If it is the case that export in the small or medium-sized firm is given a relatively limited role in the short term, perhaps mainly of a passive or reactive nature, then it must surely follow that the strategy pursued should arise out of the objectives sought, which may not necessarily involve sales or market share maximisation in export markets.

Indeed, further justification of such an approach lies in the concept of "low market share strategy", as defined by Hamermesh et al (233) and discussed briefly in 2.1(c) above. If, as argued by Kotler (307), it is thought that the response function to marketing efforts is most likely to be an S-shaped curve, then a low market share strategy may be attractive.

This may be argued on the basis of the figure below.

FIGURE 1 THE MARKETING RESPONSE FUNCTION




This case may be put in the usual way, in terms of the hypothesised sales response function shown. While it is normally argued that there are increasing returns to scale in the range of marketing efforts from B to D, from the viewpoint of the smaller firm struggling to make an impact on a market, the relatively large increase in effort from A to B produces only a small sales increment from $L_2$ to $L_1$. In other words, the small exporter may be justified in accepting sales at $L_2$ in an export market, in return for the minimal level of marketing effort of A. Further, it may follow that if many markets exist, it may be more productive to expend minimal effort in a larger number of markets, than to make more substantial investments in a limited number.

In broader terms, it was pointed out in 2.1(b) above that while the accepted wisdom is that large market shares are associated with high profitability and vice versa [see, for example, Buzzell et al ( 93), and attempts to correlate concentrated markets with high profits: Nickell and Metcalf (387), Cowling and Waterson (123), Hart and Morgan (243), and the Boston Consulting Group ( 75)], there do not appear grounds for assuming that the pursuit of market share will necessarily increase or maintain profitability for the exporter.

Recently in this area, Hamermesh et al (233) have described case histories of companies which do not have dominant market shares, but which are profitable and growing, and they conclude:

> "we have found that a small market share is not necessarily a handicap; it can be a significant advantage that enables a company to compete in ways that are unavailable to its larger rivals." (233)

This may be reinforced in the present context: if, as is argued and illustrated shortly, British goods have an undesirable reputation, national stereotype or image abroad, then the alternatives faced by the exporter may be either to accept the business which is easily available, or to spend heavily to overcome the competitive disadvantage suffered from the image of British goods and the perception of imported products.

At this stage, it is argued on such grounds that there can be advantages in accepting a low market share in a larger number of markets in export, as opposed to pursuing market concentration, and by implication competing for market share.

If it is the case, as some claim, that U.K. exporters rely on price competition because of a relative weakness in terms of non-price competition (see 3.1(d) below), then it may be that it is sound for an individual exporter to tap the price-sensitive segments of a large number of export markets, particularly given the relative inflexibility of the product offering in the short-term. This may be the case, for example, with the developing country markets, where Leff (327) has pointed out that there tends to be a high price elasticity of demand for non-agricultural products, making a strategy of low price and high volume potentially profitable.

Pursuing this further, it might be claimed that the very fact that the U.K.'s competitors concentrate on key markets (assuming that there is some international consensus on the most attractive markets) means that two points emerge. Firstly, it may be that U.K. exporters would find themselves joining in fierce competition for the same markets as others, as suggested by Kotler's "majority fallacy", and secondly, there may be a profitable opportunity open of avoiding direct competition and taking business cheaply from the smaller markets which do not attract such a high degree of competition.

In some ways this leads the argument back to the possibly misleading and invalid assumption that a country as an entity is the same thing as a market. For example, if one exporter markets only to the U.S.A., West Germany and Japan, there would appear to be concentration on key markets. On the other hand, another exporter might be dealing with ten or more African states and as many South American countries, and would appear to be market spreading. Yet in reality, the apparent concentration on three markets would probably require substantial variations in products and marketing policies between the markets and within them. On the other hand, the firm serving twenty or more countries, may have one product offering and two agents, and define the market as the developing world, and arguably could be said to be concentrating. In these, admittedly extreme, examples the advantages are reversed.

A separate and perhaps even more fundamental point is that the concentration argument assumes that firms have the ability to choose wisely in order to select key markets, and therefore assumes that information is available to make such choices. Given what has already been said about the motivation to export and the incremental internationalisation process, it seems that some doubt may be cast upon the validity of this assumption.

Note might be taken, for example, of Hunt's finding in a study of export management in medium sized engineering firms (259) that the management attitudes and lack of analysis had led to unfavourable regional specialisation compared to overseas competitors.

BETRO suggests:

> "Companies can often identify their best markets (i.e. where sales are largest or most rapidly expanding) They can also identify their most profitable markets," ( 62)

This appears open to dispute, firstly in terms of the implied criteria of market choice, particularly in the context of any market life cycle concept; and secondly, in terms of the ability and practice of exporters in assessing export profitability, as discussed in 3.1(e) below.

This key issue of the availability of information to make strategic choices is pursued in the next part of the paper, but the point made at this stage is that the inability to choose wisely among many possible export markets undermines the concentration argument.

Returning to the main theme of this section, it appears valid to suggest then that concentration and spreading may be seen as alternatives, where the balance of situational factors determines which is the more attractive.

This may be partly justified by re-introducing Kotler's statement on segmentation strategies (307). This has it that concentration is a form of differentiated marketing strategy, and thus there remains the choice between differentiated and undifferentiated strategies outlined earlier.

Having reviewed the choices open, it would seem that the empirical evidence suggests that market spreading is pursued more frequently by U.K. exporters than is concentration, and there have been some claims that this may be less true for other countries.

As noted, the BETRO report ( 62) claimed simply that:

"Many British companies sell to too many markets."

More recently, the same source has enumerated this on a comparative basis in the Barclays Bank report (271). In this latter research, in answer to the question of how many markets they exported to regularly, the results shown below emerged:

| | Percentage of all companies | | |
|---|---|---|---|
| | France | U.K. | Germany |
| Exports to: | | | |
| More than 100 markets | 32 | 40 | 20 |
| 50 to 100 markets | 30 | 26 | 30 |
| Less than 50 markets | 38 | 34 | 50 |
| | (N=120) | (N=120) | (N=120) |

The suggestion made was therefore that Germany and to some extent France concentrate more than do comparable U.K. exporters. The emphasis on concentration by German companies was greater in smaller businesses: only 16% of medium sized German companies exported to more than 100 markets (compared to 36% of medium sized U.K. companies), and 60% of medium sized German companies exported to less than 50 markets. (These figures are given in detail in Appendix I ).

Although comment is not made by the authors of the report, the detailed figures given suggest that there is a danger of exaggerating the comparative differences. For example, it might be noted that the proportions of French, U.K. and German small companies selling to less than 50 markets is respectively 65%, 60% and 76%. Similarly, the proportions for French, U.K. and German medium sized companies selling to less than 50 markets are respectively 46%, 46% and 58%. It is really only in the large company sector (taken in the Barclays Bank report as firms selling more than £75 millions p.a.) that the difference is striking that is where 30% of German companies sell to less than 50 markets compared to 7% of U.K. companies.

The universal application of these figures has, necessarily, to be seen in the context of the research methods used, particularly since it seems that the universe sampled was "successful" or "committed" exporters, that is, those with export sales accounting for more than 25% of turnover. The sample design appears to have been a quota sample with cells defined by company size and industry grouping, so that it is not possible to quantify the significance of the differences observed. It is also revealed that the sample taken included a number of multinationals. There appears to have been no attempt to account for differences in the importance of multinationals between the three countries, particularly as regards the possible differences in sourcing decisions and the effect that this would have on the number of markets served by the company responding from a particular country as an exporter. It might be speculated, for example, that the German based multinational would seek to produce abroad more often than a U.K. based multinational, because of the differences in local labour costs. Buckley and Pearce ( 87) have recently pointed to significant variations in sourcing policies between countries, where:

> "national characteristics are stronger explanatory variables than industry groups".

While no more is possible here, there certainly appear grounds for being wary of drawing firm comparative conclusions from the data given.

Even more serious though, as noted earlier, is the danger involved in assuming from this kind of comparative data that since Germany's share of world trade is growing faster than the U.K.'s, then if U.K. exporters concentrate on key markets, it follows that performance will be improved.

To begin with, it seems likely that success in gaining a high share of a limited number of markets may reflect strengths more fundamental than simply the decision to concentrate. The sources and nature of international competitiveness are explored in 3.1(d) below, but at this stage it may be suggested that German strengths in non-price competition may provide the ability to gain high market shares in the most attractive markets. If this advantage exists, it then may make sense to exploit it through concentration to reduce marketing and administrative overheads and possibly improve profitability. It follows then, that to emulate such success requires far more than simply a decision to concentrate on key markets.

Further, also noted earlier, a dynamic analysis has to account for the fact that if strong competitors have truly concentrated on key markets, and if their criteria for market choice are similar, then access to these key markets may be restricted by existing loyalties and competitive structures. The relative power of non-price competition to achieve such effects compared to price competition has already been mentioned.

It might be added that in comparative terms, the relative degree of market concentration may be partly obscured by the emphasis of, for example, Germany on the largest world markets (and thus fewer), while any attempt to avoid head-on competition may automatically require the exporter from another country to deal with a larger number of smaller markets.

It may also be noted that empirical evidence from other sources suggests that Tessler's argument may be exaggerated.

Firstly, the recent IMR studies (263, 264, 265) agree that U.K. exporters pursue a wide geographical spread of markets, which is thought likely to weaken the attack on any particular area, but it appeared that comparable West German companies pursued very similar policies:

> "The very wide geographic spread of exports was noted in the survey of British companies and the logical conclusion drawn that this wide diffusion of effort was likely to weaken the 'attack' on any particular geographic area or export market. This conclusion may still be valid but no comfort can be obtained for those advocating greater concentration of effort from the findings of the West German survey which show that successful German exporters also spread their sales effort over very widely dispersed geographic areas." (264)

It is perhaps worth noting that almost three-quarters of the U.K. companies and two-thirds of the German firms had increased their numbers of territories in the period 1972 to 1977, and that no respondents in either country expected to decrease the number of territories served.

It is also noteworthy that with the launch of new products, the IMR figures suggested that of U.K. companies 11% aimed at as many markets as possible at once, compared to 22% of German companies. Interestingly, rather more of the U.K. companies aimed to concentrate on a limited number of markets with new products, that is 66% compared to 49% of German companies.

The IMR work was based on a random sample of exporting manufacturers and involved approximately 280 respondents in either country, compared to the non-random sample of 120 respondents in each country who were "committed exporters", in the Barclays Bank study.

One clear difference between the samples is that in the IMR work, more than 40% of the respondents had less than 20% of their turnover provided by exports, and that more than two-thirds of the respondents were in the small and medium category, here being taken as firms with less than 1000 employees. This, together with the greater importance of small businesses in the West German economy, may suggest that the IMR figures may be more generally representative.

One other factor of interest in the IMR work was that it was noted that German exporters used product segmentation more than did U.K. exporters, and this is also found in some comparative case material. It is this case material which provides the second source of suggestion that Tessler's argument may be exaggerated.

Ohmae (396) in studying Japanese international strategies claims the importance of concentration on the key elements of success, but more in the sense of product specialisation than geographic, in a way which may be compared to the IMR conclusion about German exporters (265).

Collins and Owens (112) attempted to isolate the reasons for the success of the Swiss machinery and equipment market in the face of a consistently strong Swiss Franc, and found that among the keys to this success was the avoidance of direct competition by seeking markets not well served by others, in the form of narrow product-market segmentation.

It seems reasonable to draw from the arguments above at least the conclusions that it may be unwise to stress the universal desirability of key market concentration, or to assume a high degree of geographic concentration necessarily being pursued by foreign exporters, or to interpret too narrowly the concept of concentration.

There is no intention here to dispute the fact that the key market approach provides a superior strategy in certain circumstances, but rather to emphasise a situational or conditional analysis.

Thomas (534) views the choice of export market issue in terms of contrasting approaches: on the one hand going world-wide to exploit a technical advantage, but at the other extreme concentrating on a few key markets, when the degree of standardisation between markets is limited. This view seems compatible with the earlier comments on Kotler's general analysis of segmentation strategies.

Similarly, Hirsch and Lev (251) distinguish between alternative strategies for foreign market penetration: firstly, entering initially a small number of the most promising markets, and secondly, entering simultaneously as many potential markets as possible. Empirical work with firms in Denmark, the Netherlands and Israel found that both strategies were in practical use. Hirsch and Lev suggest that the first strategy was suitable for risk-averting firms, since it involved a low initial marketing investment and achieved more stable exporting, while the second strategy involved a higher risk and less stable future. It is of particular interest that in contrast to Tessler's claims, Hirsch and Lev found empirically that higher profitability was associated with the market spreading strategy.

These last views seem to imply the need for a situational analysis, both in explaining and prescribing the strategy to be pursued. The implications have been set out elsewhere (433) and are summarised below.

The suggestion is that a situational analysis should be based on factors grouped around the company, the market, and the marketing process.

In the company factors, the degree of risk aversion has already been considered, although there may be differences of opinion as to whether market concentration or spreading is associated with the higher degree of risk. To this may be added the question of the availability of information and the ability to select the "best" markets for exporting. Within this area mention may be made of the usual distinction between growth through market penetration or market development (as in Ansoff's analysis ( 16)), since these correspond to some extent with the key market or market spreading choice.

In the product area, it may be that the product itself may influence the choice of market strategy. Market spreading might be the favoured strategy with specialised products, for example scientific instrumentation, where most countries have relatively small markets. Similarly, non-repeat purchase products, like plant and equipment, may be associated more with market spreading. At the early and late stages of the product life cycle there may be advantages in servicing as many markets as possible, initially to gain and later to maintain volume. As argued by Thomas (534 ) the case favouring market concentration may be weakened where it is possible to sell a standardised product to many markets, and conversely strengthened where a high degree of product adaptation is necessary.

Market factors which would favour market spreading would include a case of many small markets or specialised segments throughout the world; unstable markets in demand or political terms; markets in the early or late stages of their life cycles; where established competitors have high shares of the key markets.

In terms of the marketing process, the key consideration here is the level of incremental marketing cost associated with dealing with extra markets, and in a more general way the level of marketing effort involved with a particular type of product-market. In some circumstances it may well be that the true incremental marketing cost of an additional market is low. For example, in selling medical supplies to hospitals, an additional market may involve no extra costs like additional salesmen or overseas selling offices, if the operation is based on export from the home office. Further, pursuing the same example, if communications are based on catalogues, international exhibitions and direct mail literature, and if goods are posted or freighted by independent carriers, the additional variable marketing costs may be small. Of course, at the other extreme an additional market might require local market salesmen or distributors, management efforts related to these, local stockholding, and specialised local communications, which would imply a somewhat different balance between the alternative strategies.

## Concluding Remarks on Market Numbers

The discussion of market number strategy justifies a brief summary and integration by its complexity and importance to the primary research objectives.

1. It was established that there is a widespread advocacy of market concentration for UK exporters, in contrast with the empirical view that exporters do not commonly pursue this policy.

2. This market concentration has been widely interpreted as concentration on a limited number of country-markets in exporting. This interpretation is in danger of ignoring the process of market targetting within countries and across country boundaries, recognised in marketing theory as marketing segmentation.

3. If it is accepted that concentration is simply a form of marketing segmentation, then it is possible to integrate various themes. The strategies described here as market spreading and market concentration appear virtually synonymous with Kotler's undifferentiated and differentiated segmentation strategies (307) and Boyd and Massy's market aggregation and segmentation ( 76).

4. To begin with, Kotler (307) points to the prerequisites for effective segmentation of measurability, accessibility and substantiality, the absense of these qualities making segmentation unattractive, or in terms of the argument advanced earlier perhaps makes market spreading less unattractive.

5. Similarly, Kotler argues that the selection of optimal strategy depends on factors including company resources, product homogeneity, the product life cycle stage, market homogeneity and competitive marketing strategies. This approach reflects the situational argument introduced to compare export strategies.

6. Returning to the semantic problem in 1. above, the segmentation parallel brings into play the type of international segmentation theories discussed by Boyd ( 77), Jaffe (272), Sethi (475) and Terpstra (532). Further, the country-market as the point of concentration is weakened by the extension of international segmentation through the concept of the clustering of markets: as argued by Frank, Massy and Wind (184) in terms of grouping countries by geographical location, cultural patterns, level of economic development and political climate, as tested recently by Tam (528).

The argument relevant to this present context is that clustering similar buying groups may offer greater marketing advantages than simply concentrating on single countries. For example, at the intuitive level some argue that exporters should distinguish between inter-European business and other exports, as a crude form of clustering of similar buyers.

A qualitative conclusion is that the analysis of market numbers strategy may be enriched by a marketing perspective. It is the pragmatism of this perspective to be pursued in the primary research work.

Marketing Information

As already noted, an important issue in the analysis of export risks, in adaptation to local markets and in the choice of export markets, is the availability of information for decision making. It was suggested earlier that there may be dangers in overestimating the availability of information (in the context of choosing key markets) since decision making under greater uncertainty may logically produce different results to decision making with more information.

In particular, a link has been stressed between key market concentration and marketing information. Kothari (305) claims that country orientation requires the generation of marketing information to enable choices to be made and adaptations carried out, while conversely BETRO ( 62) and ITI (271) argue that concentration allows the development of better market knowledge, once it has been implemented.

On one hand, it is clear that there is potentially a wealth of international marketing information to support the decision maker.

The existence of international information sources can hardly be disputed, varying from commercial agency ad hoc and continuous international studies to UK sources including the publications of bodies like the Economist Intelligence Unit, the clearing banks, and government sources. Further recognition must be given to international sources outside the UK, including international research agencies, but particularly secondary sources like UN, OECD, World Bank, IMF, Development Banks and others. Attempts at structuring international information sources are found in Robinson (451), Wilson (578), and Elliott and Christopher (164).

It must, however, be recognised that barriers exist to the use of such sources. To begin with, there may be search and awareness difficulties arising from the very diversity of the available information sources. For example, one recent researcher has highlighted the complexity and imperfections of information channels in international aid giving and the advantages to the exporter of monitoring such processes. Further, there is the simpler question of cost: both of primary research and the purchase of published work or subscription to sources like UN agency reports (357).

More broadly, the earlier discussion of the impact of the economics of information (in 2.1(b) above) suggested that the implicit assumption that information in both effectively available and used, undermines the robustness of many of the accepted models of analysis. It is suggested that this may be the case in the present context.

In the export field it appears reasonable to surmise that the sources of information used and the degree of information use are relatively unsophisticated for various reasons which may be discussed.

The recent IMR studies (263, 264, 265, 524) claim that the main information sources used by British exporters are intelligence sources, particularly Government statistics, sales force feedback and trade associations, while German companies emphasise the use of sales force feedback and trade associations. It seemed apparent that there was a consistent, positive relationship between company size and use of market information in exporters in both countries. At the extreme sophisticated primary data generation, for example test marketing, was used only by larger companies. These figures are given in Appendix II.

The Barclays Bank report (271) emphasised the role of banks in providing information to exporters, although most particularly in the financial area, while some 40% of the sample looked to the banks for specific market intelligence.

Similarly, a study of small, successful exporting firms by Parsons and Foster (415) suggested that only one-third had ever even considered market research, and only 11% had ever actually commissioned any. The most important information sources were again largely of an intelligence nature: personal visits, agents and exhibitions. Only 25% of the firms had used the Government B.O.T.B. information services, apparently because of a fear of Government involvement, a lack of knowledge of the available schemes, and a feeling that market research was "not for us".

These findings are confirmed to some extent by McFarlene's recent study of Scottish Queen's Award winners, in which it was found that:

> "research is .... unsophisticated, mismanaged and ranks low in budget allocations." (378)

It was found in this study that the sales force and agents provided the main source of market information in many cases and few of the firms used the B.O.T.B. services, and even fewer had ever used a market research specialist. This researcher concluded from his study that:

> "many of the medium-small exporters have been approaching export markets almost blind, depending on the abilities of either their salesforces or their agents" (378).

It seems reasonable to suggest therefore that this evidence is compatible with the earlier suggestion that the sources of information and degree of marketing information use are relatively unsophisticated in exporting, particularly among small and medium sized firms. While no judgement is passed as to the desirability or otherwise of this position, it is the case that it will have important implications for subsequent parts of the argument.

## Buyer Perceptions of Imported Products

This section is concerned with the suggestion that a significant characteristic of exporting, particularly for the smaller firm, is that overseas buyers' perceptions of imported products may be influenced simply because the products are imports, for example, in the way of national stereotyping or perhaps more fundamentally through a lack of familiarity and information. In many ways this reflects the earlier comments about the concept of information economics (in 2.1(b) and the immediately preceding section), and is the counterpart to the firm's lack of market information. This concept is pursued as further grounds for reassessing the apparent rationality of prescriptive theories of export strategy.

There is a growing body of evidence that:

> "Exporters' products enter foreign markets with a number of judgements already made about them" (134).

Darling and Kraft report that in a Scandinavian study of the impact of "made-in" labels on consumer attitudes, it was found that knowledge of the country of origin affected consumer attitudes towards products and also towards non-product aspects of the marketing mix. The evidence supported the hypothesis that judgements based on the country of origin were highly correlated with shopping behaviour and purchase satisfaction.

In the case of goods from developing countries, Gaedeke (188 ) found that the "made-in" informational input caused large changes in consumer attitudes to brands, although there were large individual variations.

Similarly, Dornoff et al (148) found that consumer perceptions of imported goods differed by country, and for consumers by socioeconomic group.

Rierson (448) in the early 1960's showed that imported products were seen as "national stereotypes", where judgements of quality varied by nations:

> "In every category (respondents) ranked American products in first place and Japanese products in last."

Later in the 1960's, Nagashima (382) went further in developing the concept that one of the critical issues in adjusting marketing strategy is cross-cultural image differences. Nagashima contrasted American and Japanese businessmen's attitudes towards products made at home and abroad. It was noteworthy that "Made in Germany" appeared to tbe the most highly appreciated of foreign labels, while:

> "'Made in England' still carries the traditional image of excellence, and maintains a strong prestige value in Japan. This is not strongly held in the United States." (382)

The nature of U.K. goods' image here may perhaps reflect the time of the empirical work, but of particular interest is the suggestion of variation between countries at a significant level.

This point of changing images over time is partly confirmed by recent empirical work by Market and Opinion Research International (342), which claimed that in 1979 British goods were seen by consumers in France, West Germany and Belgium as lower in quality, poor value for money and less technically advanced than competitors', and it was thought that British suppliers were less responsive to consumer requests and slow to deliver. On a scale of plus or minus 100, the comparative evaluations were:

| | |
|---|---|
| Germany | +66% |
| USA | +35% |
| Holland | +33% |
| Belgium | +17% |
| France | + 6% |
| Britain | -11% |

Similarly, recent replicative work by Marmet et al (346) found that in France, British products are:

"not considered particularly good value for money",
"Little advertised and not very well-known",
"reasonably finished but not particularly advanced",
"viewed as appealing more to the 'older' market".

These largely unfavourable findings were based on evaluation by French businessmen of French, British and American products.

A Lintas survey carried out at a similar time in the U.K. (343), reports that the British consumer still rates home-produced products highly, but this does not seem to undo the fundamental argument that cross-country images and attitudes are likely to affect exporting success. Indeed, it may offer some confirmation that domestic market policies may be less effective, or even wholly inappropriate, in exporting for reasons relating to buyer perceptions of imported products.

In particular, it seems that the image question is likely to influence the form of competition faced (which is to be discussed further in 3.1(d) below), on the grounds that imported goods' prices may affect perceptions in just the same way as in the case of domestic goods, which was considered in 2.1(d) above in the behavioural aspects of price theory. This may be particularly relevant to the imported product since it may be more unfamiliar to the buyer, leading to a greater reliance on the price cue. It might be further hypothesised that the interaction between the country of origin and price informational inputs could be critical to the formation of buyer perceptions. One possible situation is shown diagrammatically below.

| Exporter Country Image | | Buyer Perceptions of Imports | |
|---|---|---|---|
| | Favourable | Good value | High quality |
| | Unfavourable | Suspect low quality | Poor value |
| | | Low | High |
| | | Prices of Imports | |

It would seem then that the image issue may be important to the relative emphasis by exporters on price and non-price aspects of competition, and the related reaction to currency floatation in price and non-price terms.

In the context of key market concentration, prevailing images may change judgements on the relative attractiveness of concentration or spreading, particularly for the smaller exporter. For example, if a generally unfavourable residual image is faced by the exporter, it may not be within the scope of the small exporter to combat this, so taking a small share of a number of markets may be attractive.

Similarly, the buyer perception issue is related to market knowledge, as suggested earlier, on the grounds that the smaller firm may not have available measurement instruments capable of isolating attitudinal variables, and indeed on the basis of the available evidence is unlikely to have the necessary facilities or abilities.

## Research Objectives and the Hypotheses to be Tested

### Objective 2: Export Strategy

The second objective is to measure the number of markets served by exporters and to isolate the factors contributing to the decision to pursue market spreading rather than concentration.

From the discussion above, it seems reasonable to hypothesise that exporters in the sample will tend to deal with large numbers of export markets, or at least will not choose to deliberately limit the number of markets served.

This last qualification is necessary since the new or developing exporter may appear to be concentrating in terms of market numbers, simply because not enough time has elapsed for evidence of the practice of market spreading to appear.

In view of this, one indication of market spreading to be used is where increased export turnover is associated with larger numbers of export markets, rather than primarily increased shares of a limited number of key markets.

This leads to hypotheses (a), (b) and (c).

It is necessary then to examine the factors associated with the decision or development of export market strategy.

Firstly, it is possible that volume-orientation in export objectives, as opposed to profit-orientation, may logically be associated with market spreading, leading to hypothesis (d).

Further, it may be that market spreading is associated with passive or reactive exporters and market concentration with active exporters. This is based on the suggestion that a subordinate role for exporting in the firm may lead to the acceptance of business from any source that may appear. This is tested in hypothesis (e).

Thirdly, it appears that the concentration or spreading strategy may be associated with the perception of risk by the firm. It is suggested here that as the firm's dependence on export increases (as evidenced crudely by the proportion of total turnover provided by export), then the perception of risk in the dependence on particular markets increases. This leads to hypothesis (f).

Fourthly, there is the issue of the availability of market information to make key market choices. On the basis of the earlier discussion, it is reasonable to expect a very limited use of market information by exporters in the medium sized category, and that what is available comes mainly from subjective, qualitative and intelligence sources. If this is true, it seems likely that the information available is primarily about existing markets (from salesmen, distributors and the like), which does not seem suitable to assist in market selection. From this basis it is hypothesised that exporters lack market information of the type needed to justify commitment to key markets. This is tested in hypotheses (g) and (h).

Finally, there is the question of the role of price competition in exporting, as opposed to non-price competition. To begin with, it seems likely that a large proportion of exporters will see price as a more significant variable in exporting than in the domestic market (hypothesis (i)). Further, it is hypothesised that the role of price in exporting will be emphasised by exporters with a relative lack of market information (hypothesis (j)) and it is considered that exporters relying on price competition are more likely to be pursuing market spreading than market concentration strategies (hypothesis (k)).

<u>Hypotheses</u>

2(a) That exporters typically deal with large numbers of markets.

2(b) That there is a positive relationship between the number of markets served and the proportion of the firm's turnover provided by exports.

2(c) That exporters do not limit the number of markets they serve.

2(d) That the pursuit of volume objectives in exporting is associated with market spreading and the pursuit of profit objectives with market concentration.

2(e) That active exporters pursue market concentration and reactive exporters pursue market spreading.

2(f) That exporters consider that dealing with a large number of markets reduces the total risk faced more than dealing with a limited number of markets.

2(g) That market information available to exporters comes mainly from qualitative, subjective and intelligence sources in existing markets.

2(h) That exporters lack the market information needed to make key market choices.

2(i) That exporters rate price low as a competitive weapon in the domestic market and high in the export market.

2(j) That there is a negative association between the availability of market information and the rating of price as a competitive weapon.

2(k) That exporters relying on price competition are more likely to pursue market spreading than market concentration.

## 3.1(c) EXPORT MARKET SELECTION

The immediately preceding section of the paper has made much of the strategic issue of the choice of numbers of export markets, in terms of market concentration and market spreading, since, among other things, this is hypothesised to be a central determinant of export pricing policy. In examining this, much play was made of the adaptation to local conditions, the availability of market information and the impact of foreign buyer perceptions. Thus, many of the important considerations in export market selection have already been discussed.

It is, however, necessary to consolidate the market selection problem by a more general treatment before proceeding, since hidden within the question of market numbers is the process of choosing which particular markets to serve. This section examines briefly the criteria of selection proposed by the literature and the contra-indicators which appear to exist, finishing almost inevitably with the market information issue.

### Criteria and Bases for Market Selection

The Barclays Bank report claims that:

> "few companies choose their markets on the basis of rational criteria and many drift into areas more or less by chance or through the persistence of a persuasive agent." (271)

If this is the case, it is certainly not because of a lack of prescription for market selection criteria in the literature, some of which are considered below.

It may be that the application of "rational criteria" in reality must be seen in terms of the managerial theory of the firm considered earlier in 2.1(f), since any judgement of rationality assumes criteria to be known, and of the process of internationalisation, in which the firm may function as a reactive rather than active exporter, providing local, situational rather than general rationality.

The normative literature in this area concentrates largely on the questions of market potential and various forms of market accessibility.

Tookey (538) claims that the two main bases for market selection are satisfactory potential and similarity to the home market, suggesting that world markets can be divided into firstly, those offering little opportunity; secondly, those where demand exists, but where there are great differences between the home and export markets; and thirdly, those with immediate potential.

The Barclays International advice to exporters on market selection emphasises the study of the demand and competition position, language problems, and difficulties in operating and adapting each element of the marketing mix, together with political constraints and the consideration of local stability.

Advice to small firms by Wilson and Lockhart (579) similarly concentrates on the building of a "market checklist", which emphasises market demand and competitive position, and the problems with each of the marketing programme elements, particularly physical distribution and product adaptation.

Again with substantial similarity, Kalfayan (283) discusses the establishment of criteria for market selection in terms of market size, potential and accessibility of different types.

These prescriptive writings may be compared with the industrial practices uncovered empirically.

The IMR works (263, 264, 265) suggested that:

> "respondents appear, at least in theory, to place greater emphasis on overall market factors than on individual problems such as bureaucracy or Government controls," (263).

There appeared to be no difference between the factors emphasised by U.K. and German exporters for market selection.

The ITI work (271) suggested that the criteria of choice usually stressed: growth and continuity, price versus non-price competition, the likely reception of the product, currency problems and the scope for distribution arrangements. These were the commonest issues mentioned, although other factors like technical, psychological and legal criteria were given some attention.

There appears to be little controversial in the criteria established, although there may be more interest in the possible existence of contra-indicators, particularly in the context of market spreading strategies.

Contra-Indicators in Market Selection

Evidence of the existence of contra-indicators is provided, for example, by Blank and Greene's finding that U.S. business leaders are raising the question of whether the costs of doing business in many of their overseas markets may exceed the benefits for a variety of reasons ( 70). More specifically, factors of interest here include different aspects of distance between markets and the question of local buyer perceptions of imported products.

March (341 ) has argued that in the particular context of marketing to Japan, the local environment is complex and alien, and in a more general way he establishes this case in terms of the psychophysical, sociophysical and technological aspects of distance separating markets.

Similarly, Johanson and Vahine (275) and Bilkey ( 66) have found that the propensity of an exporter to deal with a country is directly related to the psychic distance between that country and the home market, where psychic distance is defined as the sum of the factors preventing the flow of information to and from the market.

Two interpretations are placed on this concept. Firstly, the obvious language and cultural links between certain countries may increase the likelihood of choice by an exporter, and secondly, perhaps more significantly here, that the lack of market information and familiarity may act as a contra-indicator in market choice, rather than a cue to information seeking. This latter point may be of particular importance to the concentration strategy issue and marketing information availability.

The question of local buyer perceptions of imported goods has already been discussed, but it is valid to note in this context that an unfavourable residual perception or national stereotype in a market may not simply make a market potential more difficult to achieve, but may place it out of reach for the exporter.

Information and Market Selection

It is implicit in all discussions of criteria and contra-indicators in market selection that it is assumed that information is available to the decision maker, as noted in the recent IMR findings on market selection criteria:

> "the importance attached to favourable market conditions presupposes reliable information on the relevant markets and confirms the need for adequate feedback either through information channels such as sales executives or through more formal methods of market research;" (263).

Prescriptive authorities adopt various stances on the availability of information: BETRO ( 62 ) assumes its availability without further comment; Thomas (534) emphasises B.O.T.B. facilities, while recognising the inevitable lead time in study; Wilson and Lockhart (579) recommend desk research, particularly using B.O.T.B. and Chamber of Commerce facilities; and Barclays International ( 47) point to the bank services, D.T.I., C.B.I. and Chamber of Comnerce sources.

It has, however, earlier been suggested that the use of available information by exporters is limited, as is the generation of primary data through marketing research. To assume that decision makers both have and use market information may thus be invalid.

This is tested in the primary research element of this study, under the general proposition that the effective absense of market information undermines the assumed general rationality of the prescriptive theory in this field.

3.1(d) INTERNATIONAL COMPETITIVENESS AND COMPARATIVE PRICING POLICIES

Introduction

The concept of international competitiveness is implicit in assumptions of how devaluation and floatation affect trade, and of the related international working of the price mechanism. This section of the paper falls into two parts.

The first part of the section considers briefly the definition and measurement problems associated with international competitiveness and continues with a short examination of U.K. competitiveness and the central debate of the relationship between price and non-price competition in the international market.

The second part of this section is concerned with making a comparative analysis of pricing and other competitive policies pursued by exporters from different countries, particularly the U.K., West Germany, Japan, Switzerland and the U.S.A.

Definition and Measurement of International Competitiveness

To begin with, it is noted that a recent NEDO paper (383) makes an immediate distinction between price and non-price competitiveness internationally, where the latter is concerned broadly with two aspects: the product and its marketing. The NEDO review of empirical evidence notes the high variability in the results of work attempting to measure price competitiveness empirically, although it is interesting to note that export unit values between France, Germany and the U.K. are so dispersed as to suggest significant price and quality differences.

One unifying concept is attempted by Enoch (170), who suggests that while price competitiveness is usually taken as relative export prices, cost-competitiveness and consequently higher export profitability may be positively associated with non-price competitiveness, although the NEDO report finds no evidence to support this (383).

From the points above it emerges that international competitiveness is open to various definitions and thus measurements, including, but going beyond, simple relative export prices.

A recent Economic Progress Report (157) summarised the present development of competitiveness measurements, and suggests that there is no unique measurement to estimate the net effect of changes in prices, exchange rates and productivity, but rather a number of complementary measures. The Treasury argument is that measures of price competitiveness centre basically on relative export prices, import price competitiveness and relative wholesale prices, while the alternative approach is to measure cost competitiveness. This latter approach may indicate the potential for non-price competitiveness, as suggested above, but neither price nor non-price measures take account of factors like delivery and product quality differences.

Enoch (170) argues that the relevant measurement depends on market structures, suggesting that relative export price measurements are relevant primarily to monopolistic competition, and that in other market situations other measurements are more valid. Similarly, the classic work in this area, Kravis and Lipsey (309, 310) suggests that prices based on unit comparisons are inappropriate for international analysis, since quality differences are ignored.

Definitions thus distinguish price and non-price elements of competitiveness. The first involves a number of measurements and variable conclusions about relative competitiveness. The second may be related to cost competitiveness measurements, but is dominated by various qualitative considerations.

It is not the function of this work to attempt any development in this area, this section serves simply to avoid unduly limited assumptions about international competitiveness, and to provide part of the context for export strategy decisions at the firm level.

## U.K. Competitiveness and Market Share

While it is not intended here to study the sources and trends in U.K. competitiveness at the macro-economic level, there is some relevance in recognising this issue, since it is part of the environment in which exporting firms' decisions are made.

Recent Treasury work (160) suggests that for the U.K. there is a broad association between competitiveness measured by relative prices and cost competitiveness, and the share taken of world trade, and that most measures of competitveness showed increases in the 1970's until the middle of 1977. One view from the 1960's was:

> "The only true yardstick of efficiency must be that of exports per head. And here Britain's economic position is clear. It is at the top." (340)

Unfortunately, as will be seen, other writers and measurements disagree.

The NEDO report (383) argues that while the U.K. share of world trade has been relatively stable in the 1970's, the U.K. appears to take a declining share of any increments in world trade.

McGeehan's survey of the literature (380) and more recently Ball et al ( 36) follow the distinction between price and non-price competitiveness, and it is argued that in the long-run the U.K.'s share of world trade has declined because of diminished price and non-price competitiveness, although in the short-run it may be traced to variations in domestic demand pressure. McFarlene's recent survey (378) suggested that exporters were concerned about a lack of price competitiveness as the pound strengthened, while Renton (443) has claimed that losses in world trade cannot be explained simply by relative prices.

Enoch (170) postulates that U.K. price competitiveness follows the level of the floating pound, although, as will be seen shortly, there are some arguments that this may be misleading. Odling-Smee and Hartley (394) have recently pointed out, for example, that a permanent gain in competitiveness of this kind would probably only be bought at the cost of increasing domestic inflation.

These points lead here, firstly, to a comparison of price and non-price competition, and a comparative study of various countries, and secondly, in a later section (3.3(c)) to the examination of the impact of floatation on export prices and trade volumes.

International Price Competition

The debate here centres largely on the international price-elasticity of demand for goods and, as noted in the NEDO report (383), findings are mixed. The relevance of this discussion to the present paper is mainly in the later assessment of the impact of floatation on export pricing.

It is clear that economic opinion in the 1960's favoured the traditional analysis of international demand in price terms. Mackay wrote, for example, that:

> "While price, technology, selling and administrative arrangements will all be important in the long-run, only adjustments to price can be expected to bring a substantial short-run increase in exports." (337)

Kreinin (312) considered that there was ample evidence that the international demand for manufactures was price-elastic, while at a similar time, Parkinsin concluded that the demand for exports was highly price-elastic and that:

> "Much of the explanation for the United Kingdom's poor showing in export markets might be found in a tendency for her export prices to rise more rapidly than those of other countries .... there is good reason for thinking that exports are price sensitive." (414)

Certainly, case work like Hovell's (256) confirms the apparent prevalence of the view that exports were price sensitive.

More recently, Barten and d'Alcantara ( 57) among others, have claimed that maintaining market shares requires the adjustment of export prices to world prices. In a more specialised context, Leff (327) and Moustafa (341) argue that the developing countries exhibit a high price elasticity of demand for manufactures, although this is contrasted with the developed world. Crawford (124)claimed in 1978 that the floating of the Yen was bringing higher export prices with an adverse effect on Japanese trade volumes, which appears similar to the normal commentaries contemporary with revaluations and upward floatation.

The area of greatest immediate interest is the responsiveness of demand to relative price changes induced by exchange rate changes through devaluation and floatation. A summary of some of the evidence is given here and further comments made in 3.3(c) below.

In 1970, Spitaller (512) reported that Dutch and German revaluations had led to losses of exports in most markets, in just the way predicted by traditional economic analysis.

Various pieces of work produced by Junz and Rhomberg (279, 280, 281) have suggested the power of relative prices in determining export volumes and market shares. One study found that for eleven countries over eight years, 43% of the variation in export market shares could be attributed to relative export prices (280), and it was thought that:

> "the results justify the conclusion that, on the whole, relative export prices play a significant role in the determination of exports of manufactured goods and that price elasticities of substitution may be somewhat larger than is customarily assumed." (280)

McGeehan (380) concluded that there is enough evidence to make the claim of a clear association between prices and export performance.

Bhagwat and Onitsuka ( 64) found that devaluations in the non-industrial countries in the 1960's were largely responsible for increasing trade volumes.

Deppler (144) claims that exchange rate changes bring about substantial changes in the volume of exports, suggesting the existence of high export price elasticities.

Page (432) found that large exchange rate changes offered benefits or penalties of the type predicted by traditional economic theory, although small changes were less predictable.

More recently, in 1976, Goldstein and Khan (212) found that import demand was sensitive to relative prices for eight of the twelve countries in their sample.

Artus and Sosa ( 27) found that in one industry, changes in price competitiveness had a significant effect on trade volumes for the various exporting countries.

These findings together amount to a reasonably consistent picture of export market shares responding to relative prices. However, perhaps the most interesting suggestion from the more recent studies in particular, is that relative prices may explain part but not all of share and volume changes.

The Junz and Rhomberg work cited above suggested that while variations in export market shares could be attributed to relative export prices, in the later years studied "other factors" were relatively more important (280). They suggested that:

> "the results indicate fairly clearly that price competitiveness plays an identifiable, though not dominant role in export performance .... The results of this study indicate a clear association of movements in relative prices and export performance. At the same time it is apparent that nonprice factors play an important role in the determination of a country's exports." (280)

The Deppler study (144) found that later German revaluations did not produce changes in export market shares, although most other currency movements fitted the traditional analysis.

Similarly, the Artus and Sosa piece ( 27) found that:

> "The relatively low price elasticity obtained for German exports tends to substantiate the widespread belief that nonprice factors play an important role in determining demand for German products."

Most recently this has led to the NEDO view (383) that the traditional analysis of price competitiveness following currency movements is unrealistic and that the important competitive factor is non-price competition.

It should be noted that some defence exists for the traditional views. Armington ( 22) claims that any suggestion that price factors are unimportant because of non-price competition is specious.

Recognition may be given to Manser's conclusion that in spite of economists' views on the power of international price competitiveness:

> "Much in this whole field of export costs and prices is enigma. Certainly, there is enough doubt to justify a search for a more conclusive diagnosis" (340).

In this present study, this leads to the recurring question of non-price competition in exporting.

## International Non-Price Competition

Whitman (571 ) has described a new "elasticity pessimism", in view of the apparent failure of large exchange rate changes and relative price changes to affect trade balances in the early 1970's, and others like Renton (443) point to the U.K.'s loss of competitiveness as not being traceable simply to relative prices. A recent Treasury paper (160 ) argues that there is a broad association between relative prices and share of world trade, which in the short term is helped by exchange rate falls, but that in the longer term the best protection is improved productivity and non-price competition.

The NEDO report (383) emphasises the view that price is only one of many determinants of market share, and that non-price competition includes variables like design, quality, delivery , selling, styling, speed in quotation, after-sales service, personal visits, waiting time and other factors adding to the value of the product purchased. This view may be compared to what has been described as a marketing theory of price, which places the variable in the context of the total marketing programme (see 2.1(d) above). It is noted by NEDO that studies in various industries suggest that the U.K. suffers from a relative weakness in such factors.

Similarly, Baker and Ryans ( 34) have found that product quality is rated significantly higher in international competition than is price. The recent Barclays Bank study (271) of exporters in three countries makes the claim that:

> "In all three countries .... there is a clear realisation of the need to get away from crude price competition: quality and technological advance are, rightly, seen as the most rewarding directions."

In a somewhat different approach, Isard (269) has found that there is evidence to support the contention that the products of different countries exhibit differentiated rather than substitutable characteristics, undermining many of the simpler assumptions made about the working of price.

Earlier, Kravis and Lipsey concluded that:

> "tariffs and quotas, division of markets, tendency to maintain customary trade channels, technical know-how and other factors operate to varying degrees to reduce the impact of price differences on trade flows." (309)

More recently, Gooding (213) has argued that price is not the major determining factor in exporting and Tessler (533) has pointed to the dangers of business failure apparently associated with price cutting strategies in the European market.

That non-price competitiveness exists is given, but further there are claims that it avoids, shelters from and outweighs price competition.

Apel ( 20) has claimed that German export success at a time of substantial Deutschmark appreciation was explained because:

> "the variety and quality of German goods fits almost exactly what the customer wants .... customers can rely on the dates of delivery promised by German suppliers being met. These points .... apparently are so important that the high price of the German currency unit has not had much influence on our exports."

On the same topic, Deppler (144) found empirically that German currency revaluations did not reduce trade flows, suggesting that factors other than relative prices were at work.

Armington ( 22) has suggested that non-price competition may act as a shelter from price competition, in the way argued in this paper in a more general context under 2.1(d). Collins and Owens (112) provide a case example mentioned earlier: the Swiss machinery and equipment market, where exports have risen in spite of a strong currency and high prices, and:

> "The marketing strategy .... is essentially designed to combat price elasticity of demand. The industry cannot compete on the basis of price."

The theory of price and non-price competition is pursued briefly in a small comparative analysis.

## Comparative Pricing Policies

The contention made here is that there are international differences in the use of the price variable, both in domestic and export markets. This contention is tested here against a review of the available literature and case material.

Firstly, the basis of comparative analysis should be established.

The central point to be made is that one attribute to be included in any situational analysis may be the national origins of competing firms.

It is possible to find a certain amount of support for this contention in the literature of comparative marketing and management.

Carson has argued:

> "The international, intercultural basis for comparison seems most natural for marketing since it is axiomatic to comparative marketing that variations in marketing structure and operations are generally related to socioeconomic environment." ( 95)

However, apart from Carson and some early work by Bartels ( 54) and Boddewyn ( 72), the comparative approach to marketing seems to have been given relatively little attention. This lack of development is surprising given the arguments advanced as to the potential value:

> "Comparative marketing is the organised study of marketing systems in many countries - the similarities, differences and the reasons therefore" (532).

Such study is claimed to offer the marketing analyst advantages of various kinds:

> "The great merit of comparative studies in business .... is the new perspective and better understanding of home institutions and environments" (452),

> "Innumerable barriers lie in the way of the international marketer .... knowledge of the business culture, management attitudes and methods of business can remove many of these barriers." ( 97)

Another theorist warns of the evident dangers in individual stereotyping, but suggests that international generalisations may be useful:

> "first, because they indicate the characteristics which are most common among that group of people ....
> Second, the generalities often describe the codes of commonly approved practice in a country, its ideology, and its standards .... Knowledge of the codes is helpful to the businessman in understanding how others feel about a situation and how he will be expected to act." (173)

If the validity of comparative analysis is taken as thus justified in the present context, then it may be possible to formulate the contention that differences exist in the use of price by managers in different countries, that reflect many national differences of various kinds.

Indeed, in some ways the need and usefulness of a situational approach of this kind is reinforced by comparing the diversity of pricing theories seen in 2.1 above, with the inherent diversity in practices in the international setting:

> "Business behaviour is derived in large part from the basic cultural environment in which the business operates, and as such, is subject to the extreme diversity which is encountered among various cultures and subcultures." ( 97 )

If this latter diversity exists, then differences in the use of the price variable may be explained and perhaps ultimately predicted, partly on the basis of the cultural norms and values of managers, and the marketing conditions under which they operate.

The hypothesis that there are systematic national differences in the use of price is evaluated by a review of the available literature and case material, analysed by national identity around a number of key pricing issues.

Initially, however, it is necessary to recognise that some evidence may appear to refute the hypothesis.

It is claimed by Ball and Duffy ( 35 ) in examining the price behaviour in a variety of European countries, compared to the U.S.A. and Japan, that the:

> "results as a whole suggest a considerable similarity of behaviour among countries included in the analysis .... in price behaviour among the countries surveyed there are substantial common elements .... One might therefore tentatively conclude that the general price/cost model developed has considerable applicability across a wide range of countries."

The data reviewed by these writers suggest that the basic cost model accounts for more than half the annual price variation in all cases except Austria and Germany, and almost three-quarters of the price variation in two-thirds of the countries.

Two points appear noteworthy in this context: Firstly, that a substantial and variable amount of price variation is not attributable to cost, and secondly, that the major comparative interest here is in the managerial use of price, rather than the aggregated price/cost relationship.

It must further be recognised that the differences in the role and use of price may reflect factors other than the exercise of managerial discretion in decision making, such as cost changes and the underlying relative economic performance of the economy. In other words, the potential for managerial discretion may differ, rather than the way in which discretion is exercised. This potentially damaging argument is not refuted here but an assumption is made that since a substantial time-span is taken in the analysis, then it is permissible to set this point aside for the time being. Additional support comes from the significant influences on price arising, it is claimed, from the way in which the firm is run, rather than the reaction to outside forces ( 89).

The evidence is summarised in Table 1 below, and then discussed around the key issues of price and non-price competition, pricing methods and price flexibility.

TABLE 1 SUMMARY OF COMPARATIVE PRICING POLICIES

| | U.K. | WEST GERMANY | U.S.A. | JAPAN | OTHERS |
|---|---|---|---|---|---|
| (a) Price and Non-Price Competitive Strategies | Price Competition | Non-Price Competition | Non-Price Competition | Price Competition (for volume) | Switzerland Non-Price Competition<br>Europe More Price Competition than U.S.A. |
| (b) Pricing Methods | Full-cost, cost-plus pricing at home and abroad | Market pricing | Cost and competition pricing | Cost pricing domestically and market pricing for exports (marginal cost pricing) | |
| | Low responsiveness to demand | Responsive to demand | | | |
| | Not prepared to lower export prices | | Not prepared to lower export prices | High home prices, low export prices | |
| (c) Price Flexibility | Rigid prices | Flexible prices | Rigid prices | Flexible prices | |

(a) Price and Non-Price Competitive Strategies

United Kingdom - Broadly, it would seem that the U.K.'s competitiveness emphasises price competition, at the expense of non-price factors. A number of recent studies stress the tendency to greater use of price competition than other countries, for example the IMR surveys (263, 264), the NEDO report on exporting (383) and others (533, 378). There is some suggestion that this emphasis on price is greater in the export than domestic market (96), and many have noted a tendency for domestic price to be rigid for various reasons, while export prices are relatively more flexible (9, 353, 490).

West Germany - The clear conclusion researchers reach regarding German market success is that of the power of using non-price forms of competition, which in exporting appears to have outweighed the disadvantages of a strong currency and its effect of relative prices. Apel (20) argues that variety, quality and reliability in delivery explain German success, and similar points are made by Artus and Sosa (27), Tessler (533) and others (99, 165, 264).

U.S.A. - French (186), on the basis of a market comparison has claimed that:

> "American and European businessmen appear to have different points of view regarding the role of price."

The now almost classic Udell research (552, 554) certainly suggested that price was rated fairly low as an element of competitive strategy by U.S. businessmen, as compared to non-price competition, which was confirmed to some extent for U.S. international pricing by Baker and Ryans (34). Terpstra (531) and Boddewyn and Hansen (71) in examining U.S. marketing in the E.E.C., found that U.S. companies tended to compete mainly on non-price factors (as in the U.S. domestic market), while European companies tended to respond to new competition on a price basis.

There are certainly claims that U.S. domestic marketing emphasises non-price aspects of competition, for example by Leff (327), while the contrast with the international market is shown by Weinrauch and Rao:

> "According to exporters, export pricing requires modification to a greater degree than any other factor." (564)

This appears compatible with other findings on the rate of product innovation (99) and Samli's conclusion (477) that successful U.S. exporting firms were priced at or above the level of local competitors, while less growth was achieved by firms priced below local competitors.

Japan - There appears some degree of consensus that Japanese companies (with Government support in some cases) have tended to pursue a policy of low export prices supported by high prices in the domestic market.

Recently, Rose (456) has examined Japan's approach to exporting and concludes that:

> "the typical Japanese manufacturing company makes dedicated efforts to increase its market share. If the company can only achieve this goal by cutting prices, it will normally do so, despite the possible short-term penalties."

Rose contrasts this Japanese stance with the fact that:

> "few American companies were willing to cut export prices".

Similarly, Nevin (385) gives a number of examples of cases where Japanese export prices are low enough to undercut local producers, are lower than Japanese domestic prices, and, it is claimed, are in some cases less than the costs of production and delivery. On the other hand, Ohmae (396) explains Japanese competitive policy as avoiding head-on competition, which may be relevant to assessing the apparent change in Japanese export marketing discussed below.

In commenting on the claims of being protectionist and dumping products abroad, Drucker notes that:

> "of all the complaints foreigners have about Japan, this is the one the Japanese themselves understand the least." (149)

Drucker points out that past policy has been to maintain domestic prices, while selling cheaply abroad, but that under modern conditions this is inappropriate, but that change is:

> "still beyond Japanese political will and social imagination".

In terms of changing policies, Oba (393) has suggested that the emerging strategy is one of competing on technology and service. Oba claims that as a result, Japanese export pricing is becoming less flexible. In similar vein, Smock and Hoeffer (505) consider that in the U.S. market price was the main Japanese thrust the the 1960's and early 1970's, when goods were:

> "priced low regardless of actual cost, to maintain the high volume of exports",

while now non-price competition is becoming dominant. This change may reflect the avoidance of head-on competition in the way postulated above by Ohmae, or perhaps a changing price philosophy over time.

Recently, Keegan (293) has raised the question, in the context of the Yen floating upwards, of whether such competitive pressure can work in a situation where the domestic Japanese market is so protected from international competition that the great Japanese trading companies can carry the extra cost through monopolistic pricing policies at home.

Other Countries - While noting the earlier claims that European countries are more oriented towards price competition, one recent case history of the Swiss Machinery and Equipment market by Collins and Owens (112) shows that a strategy of competing in segments where price was less significant was adopted since the industry could not compete on price. This may be contrasted with other European approaches, and paralleled with Ohmae's analysis of Japanese success.

(b) Pricing Methods

United Kingdom - Studies have reported variously on the cost orientation of U.K. pricing, both domestically and in exporting. Brechling noted:

> "It would appear that British export prices are rather more cost-determined and less demand-determined than German ones, and probably others too" ( 79 ).

This comparison was to some extent confirmed by Ball and Duffy's work ( 35). Surveys by Hunt (259) and Hunt et al (260) found that cost-plus pricing was the main approach in pricing engineering exports. Similarly, McAlley (376) has commented on the reliance of U.K. firms on cost data for pricing, and more recently Arpan ( 24) has drawn attention to a British preference for cost-based international transfer prices. McFarlene (378) points to the common use of full-cost export pricing, confirming the earlier Atkins and Skinner (28) study of domestic pricing methods. A direct consequence of this price methodology is the observation that U.K. prices are relatively unresponsive to demand, as claimed by Wells (567) and the BETRO report ( 62).

West Germany - Brechling's work (279) claimed that German export prices were responsive to demand rather than being primarily based on costs:

> "as long as world demand was buoyant .... the rise in German export prices exceeded that in British ones. Thereafter however, when world markets quietened down again German export prices fell by more and subsequently rose by less than British export prices."

Similarly, the Ball and Duffy analysis ( 35) suggests a lesser emphasis on costs in price determination in the domestic German market. In a related way, Arpan ( 24) notes a German preference for systems combining cost and market elements in multinational firm pricing.

U.S.A. - Oxenfeldt and Baxter have claimed that:

> "cost-plus is probably the primary method of fixing price in American industry - and is probably even more common abroad." (401)

This stance is to some extent confirmed by a similar view put by Caterora and Hess ( 97) and Burkhart's finding ( 89) that factors within the firm led to prices not responding to demand, together with Arpan's conclusion that U.S. firms use cost-oriented rather than market-based prices ( 24).

It is, however, noteworthy that Baker and Ryans ( 34) considered that U.S. international pricing was cost and competition oriented and Udell (553) found that domestically, pricing to competition was the most important approach, followed by cost-plus, although this relationship varied from industry to industry.

Japan - There are some indications that domestically Japanese pricing policies conform to the common mark-up principle, with demand influences, as for example shown by Shinkai (487, 488), Shinjo (486) and Ball and Duffy ( 35).

However, as noted above, there is some agreement that Japanese exporters have pursued volume through price competition, in some cases apparently regardless of the short-term profit consequences. This amounts to market-based, rather than cost-based pricing, of an extreme kind. There have also been suggestions that this approach may reflect a marginal or incremental cost approach, as opposed to a full-cost approach, for example by Davies (134).

Other Countries - There are some general thoughts that European pricing has tended to be cost-based, for example, by Phlips (430) and Arpan ( 24). On the other hand, successful competitors are associated by some with incremental rather than full-cost approaches:

> "Incremental cost will always be the rock-bottom price .... By accepting this approach the competitiveness of British industry in the export markets would be increased. Our competitors have been applying it to their pricing of exports for many years in a more widespread manner than ours and this has helped enormously in their ability to outsell us." (134).

(c) Price Flexibility

United Kingdom - Probably related to the apparent prevalence of cost-plus pricing, is the claim that U.K. prices are rigid and unresponsive to demand. This criticism is made by various researchers, for example:

Brechling (79), BETRO (62), Ray (441), Hunt (259), Hunt et al (260), and Wells (567).

West Germany - Correspondingly, the earlier points made regarding the market orientation of German pricing, lead to an observation of a greater tendency to flexibility in prices, for example Brechling (79).

U.S.A. - Similarly, the evidence of cost-orientation in U.S. pricing is related to suggestions of price rigidity.

Japan - Again, there is a presumption that market oriented prices amount to flexible prices, although recently Oba (393) has pointed to less flexibility in Japanese export pricing as the Yen has strengthened against other currencies.

This brief survey of the literature and cases appears to support the hypothesis that there are systematic national differences in the use of price by management decision makers, in setting both domestic and export prices.

The specific differences are organised around the strategic use of price as a form of competition, as opposed to non-price factors, the approach used in setting prices, and the apparent flexibility of prices, which is largely determined by the price setting methods used.

The differences established and summarised above are such that the common prescriptive arguments are not introduced here, but that it is proposed that national differences should provide part of any situational analysis for the purpose of explaining and predicting competitive price behaviour in the domestic and international marketplaces.

## 3.1(e) EXPORT PROFITABILITY

Any consideration of pricing must necessarily examine the issue of profitability, in view of the close relationship between the two. Here, the interest is in the differences between the profitability of domestic and export sales, the impact of exchange rate movements on domestic and export profitability, and the inherent problems of measuring export profitability.

Hovell (256) noted in his export pricing survey that a number of his respondents considered that the issue of export profitability was irrelevant because exports were essentially pursued for growth. However, it is more usual to argue that:

> "1) The views held about the profitability of exports will determine the priority given to them (indeed, will decide whether a Company will export at all).
>
> 2) Many companies (with excellent products) are deterred from exporting because - on the basis of their present cost calculations - they do not find exports proftiable enough." ( 62)

Differences Between Export and Domestic Market Profitability

The prevailing belief over a significant period of time seems to have been that export sales offered lower levels of profitability than domestic sales.

Gribben ( 220) claims that such differences are thought to exist because of overseas selling costs and transport costs, but his conclusion was that the differences are, in fact, not so much caused by costs as by the pressure of tariffs and international competition on export prices. Similarly, in a study by Tookey (539) in the early 1960's, textile firms claimed that exports involved longer payment times, uncertainty of payments, additional marketing costs and extra administration, while these cost increments could not be met by increasing export prices.

Certainly, the finding that export sales are widely considered less profitable is common to many studies: Ball et al ( 36 ), BETRO:

> "one of the greatest restrictions on exports has been the widespread belief that they were much less profitable than sales to the home market." ( 62),

Blank and Greene ( 70), Gribben (220), Hague et al (227), Hovell (256), Hunt (259), Livingstone (334), Mackay (337), PEP (428), Putterill (437):

> "The export field is only marginally profitable",

Rosendale (457), and Tookey (539).

However, two observations may be made and pursued. Firstly, most of these studies are concerned with the 1960's and early 1970's , and with management beliefs rather than validated facts, and secondly, it is clear from the points made in 2.1(c) above that the judgement and measurement of profitability is a function of the measurement methods used and their interpretation for different purposes.

To begin with, it seems that various findings suggest that export profitability may have risen in the post-devaluation and floatation period. Gribben (220), for example, argues that before devaluation the main cause of lower average profit rates from exports was the lower level of prices obtained in the export market, while devaluation allowed relative prices to adjust, thus improving export profitability. Similarly, Livingstone (334) has claimed that until the 1970's the U.K. home market was more profitable than export, but that this was less true of the 1970's because of such factors as government price controls in the domestic market and floating exchange rates abroad. To this argument may be added the evidence of a steady decline in U.K. home industrial profitability (167) which influences comparisons. This appears compatible with the NEDO claim (383) that the major benefit of devaluation or depreciation in floatation may be improved levels of profitability.

It does seem that recent empirical work finds that exports are considered more profitable than the home market.

McFarlene's survey (378) of successful exporters, at a time when the pound had depreciated substantially, concluded that exporters found exports more profitable than home sales.

The BETRO study noted:

> "51% of companies interviewed find exports more profitable than sales in the home market, due partly to the downward float of sterling and partly the possibility of raising prices in export markets where price restraints are not normally imposed." ( 62)

More recently, the Barclays Bank report (271) contrasts home and export profitability for U.K., French, and German exporters. In response to the question of whether exports were more profitable than sales in the home market, the following results were obtained:

| | Percentage of all companies | | |
|---|---|---|---|
| | France (N=120) | U.K. (N=120) | Germany (N=120) |
| "Yes, more profitable" | 31 | 57 | 17 |
| "Less profitable" | 50 | 28 | 46 |
| "As profitable as home sales" | 12 | 15 | 29 |
| "Varies" | 7 | - | 8 |

Tessler (271) avoids the convenient interpretation of such data to conclude that export profitability is inversely related to currency strength, and suggests instead that the data above indicate that French and German managers interpret cost and profit data differently.

This leads to the point already mentioned: that the key to the issue is the measurement instruments used and their interpretation.

Measuring and Interpreting Export Profitability

While some like Grimsley (221) propose a costing programme for export sales distinct from home sales, the BETRO finding was that:

> "Most companies use the same method of costing for the home and export markets,"

with the consequence that:

> "it is not recognised that this approach to costing frequently under-rates the profitability of exports (particularly in companies with high overheads and with a substantial home market involvement)" ( 62).

Certainly, as recognised by BETRO, if costs include large overhead allocations it may be the case that exports "subsidise" the home market, rather than the reverse. The BETRO report advocates a more discriminating allocation of overhead to arrive at something approaching marginal or incremental costing.

The more recent Barclays Bank report (271) points to the ambiguity of cost data and stresses the differences in interpretation that are possible, again favouring the view that lower profit rates do not make exports unattractive, and claiming that this view is common among German exporters:

> "The export director of a very successful German company summed up this whole issue admirably when he explained why it was in his company's best interest to continue with 'less profitable' exports: 'Take away these exports, and you would reduce production volume by over a third, unit costs would go up significantly, we would be less competitive with imports, and would probably have to lay off some ten thousand employees." (271)

These measurement and interpretation issues are not pursued here, since the main elements of the problem have been discussed in 2.1 above in a more general context. Clearly, the profitability question will be relevant to the analysis below of reactions to floatation, in 3.1(c) and export pricing, in 3.1(b).

# 3.2 EXPORT FINANCE

## INTRODUCTION

It is the function of this section of the review to consider those aspects of export finance which are of direct relevance to the objects of this study, and no attempt is made at a comprehensive coverage of this area in its own right.

Thus, this section considers the problem of contractual terms in exporting, the working of the exchange rate mechanism, and the function of forward exchange.

Having made this emphasis on selectivity in the area of export finance, it is perhaps necessary to stress the role of bank services, particularly for the smaller exporter. as discussed in various sources ( 38, 42, 44 , 359, 419, 422). It is the role of banks for the smaller and medium sized exporter which justifies in part the exclusion here of a review of topics like export insurance, the ECGD facilities, financing arrangements, and alternative forms of payment and documentation.

## 3.2(a) CONTRACTUAL TERMS IN EXPORT

A consideration of export pricing must inevitably recognise the terms used in overseas as opposed to purely domestic trade. The chief terms are defined by the International Chamber of Commerce's Incoterms (267). The main elements of these terms are summarised in Table 2 below.

The importance of the terms of contract as an essential part of the export quotation or price is stressed by Muir (372), Terpstra (532), Kramer (308), and Kahler and Kramer (282) among others.

Recent evidence of industrial practice is provided by McFarlene (378), who notes that the commonest terms of quotation by his sample of successful exporters were FOB, although there were moves towards greater use of CIF. This reflects prescriptive work. like that of Slijper (504), which favours the use of CIF terms.

The major immediate importance of this question in this study is in defining the concept of price to be studied empirically.

TABLE 2 DEFINITION OF INCOTERMS

| Terms | Costs included (in addition to the base and packing and checking) | | | | | | | Delivery by seller to |
|---|---|---|---|---|---|---|---|---|
| | Documents | Loading/ delivery to loader | Export licence fees, taxes | Carriage to port of destination | Unloading | Marine insurance | Import taxes, duties | |
| Ex-Works | | | | | | | | Named or usual place |
| FOR/FOT - Free on Rail/Truck | x | x | | | | | | Named departure point, loaded onto vehicle |
| FAS - Free Alongside Ship | x | x | | | | | | Named port of shipment, alongside vessel |
| FOB - Free on Board | x | x | x | | | | | Named port of shipment, on board vessel |
| C&F - Cost and Freight | x | x | x | x | x | | | Named port of destination, |
| CIF - Cost, Insurance and Freight | x | x | x | x | x | x | | Named port of destination |
| Freight and Carriage Paid To | x | x | x | x | | | | Named point of destination (inland) |
| Ex-Ship | x | | | | | | | Named port ofdestination |
| Ex-Quay (duty paid) | x | | | | | | x | Named port |
| Delivered at frontier | x | x | x | x | x | | | Named place on frontier |
| Delivered (duty paid) | x | | | x | x | | x | Named place of destination in the importing country |
| FOB Airport | x | x | x | | | | | Named airport of departure |

## 3.2(b) EXCHANGE RATES

Since a central theme of this study is the impact of floatation on export pricing, it is clearly necessary to examine the background of exchange rates, and this is attempted in this section of the paper.

As in the preceding section, comprehensiveness is not claimed, but this part of the review sets out to study briefly the underlying theory of exchange rates and their determination, and secondly to summarise the recent history of exchange rate movements, leading lastly, to an examination of the apparent impact of exchange rate movements on business.

### The Post-War History of Exchange Rates

An attempt is made here to trace briefly the recent foreign exchange arrangements internationally and the determinants ofexchange rate changes.

The Bretton Woods agreement in 1944 is thought by Lethbridge and Tylee (331) to be:

> "a victory by the defenders of fixed exchange values over those who wanted more flexible rates".

Under this system, changes in exchange rates were allowed:

> "only when essential to the correction of fundamental disequilibrium in its balance of payments" (331).

It is argued that in practice there was a strong feeling against the devaluation of a country's exchange rate against gold, and many suggest that the point of "fundamental disequilibrium" was never satisfactorily defined.

In fact, Teck (530) points out that:

> "During the so-called 'fixed rate' experience under the Bretton Woods agreement, there were more than 150 official parity changes among the currencies of countries in the IMF .... Parity changes of between ten and forty percent were by no means uncommon."

The Bretton Woods system "began to cause increasing concern throughout the 1960's and early 1970's" ( 41) for reasons traced to confidence, international liquidity and the problems mentioned above of the adjustment issue, although there are disagreements as to the detailed reasons for the breakdown of the fixed rate system (167).

Of particular local interest was the 15% devaluation of Sterling in November 1967, after a three year struggle to avoid the move, which led the Bank of England to "the largest speculative loss ever recorded on the foreign exchange market" (331).

1971 effectively marked the end of the Bretton Woods era ( 41), since a number of currencies were floated. The adjustable peg system was temporarily extended by the Smithsonian agreement in December 1971, which consisted of a general realignment of currency values.

The adjustable peg system eventually broke up in 1972-73, in favour of floating exchange rates, the pound being floated in June 1972. The floatation of the pound forced the U.K. to leave the E.E.C. "snake" formed in May 1972, this arrangement being one where:

> "the members agreed to maintain no more than a $2\frac{1}{4}$% 'band' around their respective fixed parities (the 'snake') whilst moving as a bloc within the $4\frac{1}{2}$% Smithsonian 'band' (the 'tunnel')." ( 41)

In floatation a country chooses whether to let its currency float independently or in a group float (such as the snake), while in pegging a country chooses a single foreign currency or "basket" of foreign currencies (245), the theory being that floating rates provide an automatic means of eliminating balance of payments defecits.

To date most of the leading industrial countries have floated their currencies, normally in a managed float, where exchange rates are influenced by Government intervention. However, Emminger (167) points out that only 38 members of the 133 in the IMF are floating, since in 1978 95 members pegged their currencies to a single currency or basket.

The U.K. experience has been one of substantial devaluation and revaluation against other currencies in the period of floatation. The movement of the pound is shown in Appendix III covering a number of years.

The most significant points historically in the float were probably firstly, in March to June 1976, when the pound fell below $2 for the first time, and dropped in value to $1.64 by June, and according to Fay and Young: "the pound nearly died" (172), before being rescued by IMF support and a reduction in the role of Sterling as a reserve currency. The second significant period is 1977 to present, when the pound has strengthened, being allowed by the Government to float freely in 1977

(262, 294, 523), with the pound returning to $2 in 1978 (293, 435).

The future for the pound is less certain. Many commentators have speculated that in the pursuit of stability, the U.K. might participate in European monetary co-operation (125, 126, 290, 291), most recently in the form of the European Monetary System.

In 1978, Britain was committed "in principle" (291) to EMS, although the official stance in January 1979 was:

> "Britain is to join the other member states of the EEC in setting up the EMS .... But the Government decided that Britain should not join in the exchange rate mechanism at the outset" (158).

The EMS exchange rate mechanism proposed derives from the snake arrangement and functions through each currency having a central rate against a European Currency Unit, and thus against each other participating currency, giving a "parity grid" with a maximum fluctuation of 2¼%.

<u>The Determination of Exchange Rate Values</u>

Broadly, it is possible to distinguish between economic market forces and Government policies in the determination of actual exchange rate values.

In terms of market forces, the theory of exchange rate determination normally advanced is that of purchasing power parity (39, 45, 395, 416, 459, 472). This holds that exchange rates adjust so that the relationship between what a unit of a particular currency will buy abroad and domestically remains approximately the same, thus exchange rates offset differential rates of inflation between countries in such a way as to restore balance of payments equilibrium.

On the other hand some favour an asset-value theory (416, 467), where the exchange rate is an asset price, that is:

> "the relative price at which the stock of money, bills and bonds and other financial assets of a country will be willingly held by foreign and domestic asset holders." (416)

Then a change in the exchange rate or change in the expectations about future rates can cause asset holders to change their portfolios, giving a change in the demand for foreign currency and possibly sharp fluctuations in exchange rates, through a form of accelerator effect.

This theory offers some insight into the high short term variability of exchange rates, rather than long term trends.

At a less analytical level, it is often suggested that:

> "Rates of exchange fluctuate with the supply and demand for a particular currency, often influenced by a range of other factors - political, economic, financial etc., and by changes in official parities." ( 45)

In supply and demand terms, the major determining factors are trading, investment and speculation.

Attempts have been made to establish exchange rate forecasting systems based on underlying economic trends, for example by Murenbleed (373) and Goeltz (208), but it must be recognised that Government intervention is the defining characteristic of managed floating.

Smyth ( 506) for example, saw devaluation as a way for the UK to break out of the "stop-go cycle" in the economy, and Tower ( 542) has assessed the use of exchange rate policy as a balance of payments instrument.

Certainly, recent commentators have traced the management of floatation to Government policy rigidity ( 223), the pursuit by the Treasury and the Bank of England of stability against the $ US in 1977, a policy of allowing the pound to rise in 1978 ( 262, 435) and at the most extreme actions to avoid the purely political dangers of a rapidly devaluing pound.

Recently, Keegan (290) has argued that "sterling cavorting" may be explained by the sequence of contrasting policies pursued by Governments during the later 1970's. Keegan's analysis distinguishes:

<u>Exchange Rate Policy 1 - A Competitive Pound</u>
<u>the policy pursued in the Spring of 1976:</u>

"to engineer a controlled drop in the pound to win back for industry the competitive edge"

which led to the unacceptable:

"precipitous decline in the pound".

<u>Exchange Rate Policy 2 - A Stable Pound</u>
an explicit policy intended to achieve:

"a more stable environment .... to concentrate the minds and nerves of industrialists".

<u>Exchange Rate Policy 3 - A Strong Pound</u>
a policy made possible by the return of confidence after 1976 and North Sea revenues, leading to the position in July 1979 when the pound had reached a point of being 20% stronger than at the end of 1976.

Exchange Rate Policy 4 - No Exchange Rate Policy
the Conservative administration in 1979 pursued a policy of:
"The Exchange Rate is determined by market forces".

Exchange Rate Policy 5 - A Less Uncompetitive Pound
this has arisen from the floating upwards of the pound under policies 3 and 4, and is similar to policy 1.

It is clear therefore that any predictive aspirations in exchange rate analysis are directly influenced by expectations of Government actions.

The Impact of Exchange Rate Changes on Business

In the context of the recent history outlined above, it is clear that many claim and assume that devaluation and floatation significantly affect export prices and thus export volumes and market shares, while there is additionally an implication for domestic costs and prices and indeed for the level of business confidence (106, 205). Certainly, during the rises in the pound's value in 1979, commentaries have consistently advanced the argument of an adverse effect on export business, although as will be discussed later similar commentaries emphasised the lack of effectiveness of a falling pound in assisting export sales. It is, however, clear that many authorities now emphasise the importance of a corporate exchange rate policy in export and international management.

Firstly, the most central issue rests on the traditional economic analysis of devaluation and revaluation affecting export prices and through a high elasticity of demand hence trade volumes. This issue is of a degree of importance to this study, and attracts a level of controversy that it is considered more appropriate to assess it as a separate topic under export pricing in 3.3(c) below.

It is perhaps relevant to note here that various sources point to the impact of devaluation and revaluation on domestic prices and costs and thus international cost competitiveness. For example, Gooding (213) cites cases of firms finding that UK inflation and import price increases outweighed the benefits of downward sterling floatation, and Fortune (178) has made similar comments for the USA. Empirically, Wilson (581) has shown the offsetting effects of domestic price increases in floatation, while recent Treasury analysis (394) has also concluded that exchange rate changes feed through to domestic prices and costs, tending eventually to offset the initial change in competitiveness.

Perhaps the most overt impact of recent changes on business has been the need to give more attention to the exchange rate problem, at least in the view of management writers. For example, Ankron ( 15), Burtle (90) and Donahue (146) point to the need for active management and review of currency problems and exposure, while Barclays International ( 45) points out that such problems are not restricted to the multinational corporation, but are shared by smaller exporters. Recently, Earl and Paxson (152) have suggested a need to "manage" foreign exchange by creating greater awareness among line managers and allocating exchange responsibilities, rather than simply accepting the "exchange variances excuse".

On the grounds that exchange rate floatation has direct implications for the exporter, which may be far from straightforward, but which cannot be totally avoided, this topic is pursued in 3.3(c) in the particular context of export price and strategy.

## 3.2(c) FORWARD EXCHANGE

In considering export pricing in a period of floating exchange rates, it is clearly necessary to examine the role of forward exchange as a method for reducing the burden of risk borne by the exporter (or importer).

This section examines briefly, the arguments favouring the use of forward exchange arrangements, the working of the forward exchange mechanism, and finally the level of use by exporters and the problems faced in using forward exchnage.

### The Use of Forward Exchange

It is common to most prescriptive export commentators that the use of forward exchange is recommended, particularly in the context of local currency invoicing.

Paulden notes that the "wise" decision for the exporter is to opt out of currency speculation risks (420), since:

> "forward sale of expected currency receipts, therefore, can remove the speculative element from foreign trading and, in most instances, can provide an added profit" (421).

Similarly, in recommending local currency invoicing, Day claims:

> "In these days of floating currencies and the availability of forward markets for world currencies, the risk of fluctuations in the rates of exchange are removed." (138)

This endorses earlier claims by Eltis (165), Baron ( 51), Clark (106) and Sharman (481), and more recently by Kohlhagen (303).

In this context, the recent Barclays Bank report (271) has commented on the paradox of British exporters' apparent reluctance to use one of the most highly developed forward exchange markets, available to them in the UK.

Day (138), Syrett (527), Paulden (421) and Sharman (481) feature prominently among those pointing to the possibility of making additional profits through the use of forward exchange:

> "frequently .... when an exporter quotes in his customer's currency and makes use of a forward market he can make a profit on the currency transaction as well as the export deal." (138)

On the other hand, the ITI view (271) is that the major advantage is in gaining a competitive edge by resolving the problem of fluctuating exchange rates for the buyer.

Barnes ( 49) has tabulated the benefits of covering forward:

> "1. The rate is fixed <u>now</u> for an exchange operation taking place in the <u>future</u>.
> 2. It is a firm and irrevocable commitment by both bank and customer - regardless to what might happen to the spot rate.
> 3. No cash or payment is exchanged until maturity.
> 4. Delivery can be made on any working day to suit the customer.
> 5. Forwards can be for delivery on a fixed day, or over a period at the customer's option.
> 6. Partial deliveries are permitted with option forwards."

Similarly, Barclays International ( 45) emphasise the advantages of knowledge of the exchange rate to be received in the future, regardless of spot rate movements; being competitive by agreeing to deal in a foreign currency; "eliminating" exchange risks and assessing costs more accurately, as the major strengths.

<u>The Forward Exchange Mechanism</u>

The working of the forward exchange arrangement and the decisions faced by the exporter may be briefly reviewed.

Barclays International offers the definition:

> "A forward exchange contract is a contract between the customer and his bank whereby each party agrees to deliver at a specified future time a certain amount in one currency in exchange for a certain amount in another currency at an agreed rate of exchange. No cash is normally exchanged at the time the contract is taken out, but both parties commit themselves to a cash/currency exchange on the maturity date at the original agreed rate." ( 46)

The date for the delivery of the currency is specified in a forward contract, either as a particular business day in a fixed forward contract, or a day between two dates in an option forward contract, when the payment date is not known exactly.

Forward exchange contracts are available in the UK for most major currencies, with rates quoted up to six months ahead, and in some cases up to a year ahead.

The forward exchange rate for the currency is based on the spot rate, minus the premium or plus the discount for future delivery, unless the forward rate is at par.

A premium on the forward rate indicates that the currency is stronger than Sterling, so that on entering a forward contract, the UK exporter will receive more Sterling for his foreign currency at the future date than at the spot rate prevailing when the contract is taken out.

A discount in the forward rate indicates that the currency is weaker than Sterling, so that on entering a forward contract, the UK exporter will receive less Sterling for his foreign currency at the future date than at the spot rate when the contract is taken out.

The forward rates are not forecasts of spot rates, but reflect differences in interest rates, determined by a variety of factors.

Thus the working of the system may be described as a form of insurance against adverse changes in exchange rates during the term of a contract and credit period in international trade. When the forward rate is at a premium, a forward contract not only protects the exporter's expected profit, but also offers an extra margin over the prevailing spot rate (or the ability to improve the price offered) ( 45,421 ). On the other hand, when the forward rate is at a discount, the exporter's expected profit is reduced, this reduction amounting to the cost of being protected against the effects of further deterioration in the rate.

Finally, it should be noted that the Eurocurrency markets provide an alternative to forward cover, by the exporter taking out a Eurocurrency loan in the foreign currency for the credit period involved, although this involves an obligation to repay the foreign currency, regardless of the export buyer's payment, and the exporter gives up the possible benefit of selling forward at a premium.

Problems with Forward Exchange

As a consequence of the relatively limited extent to which foreign currency invoicing has been adopted by UK exporters (see 3.3(d) below), there appears to be a relatively low usage of forward cover, as noted by the recent ITI research (271), although Reid (442) has suggested that there is a trend towards increased use of forward cover by large exporters.

A Swedish study by Grassman (216) found that only 3% of Swedish exports were covered forward, although this appeared to increase substantially after 1973 and floatation, to more than 10%, particularly with large firms and long credit transactions.

More recently, in Germany, Gehrmann et al (202) found that in their sample, some 17% of firms covered forward completely.

It may be that "uncertainty" explains the relatively low use of forward exchange contracts by exporters, as claimed in the Barclays Bank report (271), but equally there appear to be practical difficulties which provide obstacles to the use of forward exchange arrangements.

To begin with, Paulden (421) points out that the Bank of England prohibits "blanket forward-selling", and that forward exchange contracts have to be arranged for each export transaction. Paulden suggests that exporters do not find it economic to cover forward contracts worth less than £20,000 - £25,000. It seems intuitively likely that this will be of particular relevance to the small and medium sized exporters, who are the major interest in this study.

Detailed problems have been noted in a recent Midland Bank Review paper (360). Firstly, it may not be possible to obtain forward cover for the full period of a long contract, and the exporter is faced with the problems of obtaining extensions at whatever forward rate prevails at the time of the extension in the mid-point of his export contract.

Secondly, if the export contract fails, the exporter is faced with delivering the foreign currency on the specified date, possibly by buying at the prevailing spot rate (although improved ECGD cover was provided in 1976 to cater for this situation).

Thirdly, there may be no forward market in a minor currency, or the currency may be inconvertible.

It may be seen than that the financial aspect of export pricing in integral to any analysis, although the blanket prescription of forward cover may be disputed on the grounds of practical difficulties, as well as the more usual claims of management unawareness and uncertainty, which may contribute to the explanation of the relatively limited use of forward cover by exporters. Certainly, it is not felt that the existence of such financial services in any way detracts from the importance of pricing in export strategy and the particular problems of the smaller enterprise, with which this paper is concerned.

## 3.3 EXPORT PRICING

## INTRODUCTION

This section of the paper is concerned with the specific issues of export price levels, pricing methods, the impact on export pricing of devaluation and floatation and the strategy of invoice currency. The discussion of these points is carried out by drawing on the preceding examination of general pricing theories and of export management. The discussion leads to the primary research objectives and hypotheses to be tested in the area of export pricing.

Before this discussion, it is possible to review the viewpoints expressed on the nature and importance of export pricing, its complexity and the ways in which it appears that export pricing differs from domestic market pricing, by way of an extended introduction to the topic.

### Role and Importance of Export Pricing

Much has already been made of the price competition versus non-price competition debate (see 3.1(d) above) and this issue will be seen to be relevant again in assessing responses to currency changes.

However, it is certainly demonstrably true that in spite of the implications of this recent debate, much emphasis has been placed on price competition in exporting.

For example, early work by Harberger led him to:

> "point strongly to the conclusion that the price mechanism works powerfully and pervasively in international trade" (237).

At a similar time, Mackay wrote:

> "While price, technology, selling and administrative arrangements will all be important in the long-run, only adjustments to price can be expected to bring a substantial short-run increase in exports." (337).

More recently, a number of works by Junz and Rhomberg (279, 280, 281), which were cited earlier, have suggested that export prices are significant determinants of changes in export market shares, although they recognise the need to study other determinants in parallel:

> "the results justify the conclusion that, on the whole, relative export prices play a significant role in the determination of exports of manufactured products ....

> At the same time it is apparent that nonprice factors play an important role in the determination of a country's exports." (280)

In a similar way, Parkinson has concluded:

> "Much of the explanation for the United Kingdom's poor showing in export markets might be found in a tendency for her export prices to rise more rapidly than those of other countries." (414)

While these studies are of an essentially macroeconomic nature, it is noteworthy that in the recent Barclays Bank report (271), responding companies were asked if price was of decisive importance in their industries, and firm positive answers were obtained from almost half the French companies and a third of the UK and German companies. Generally positive answers (including the above and also those who thought price not decisive but fairly important) were obtained from 80% of the French companies, two-thirds of the UK companies, and a little over one half of the German companies.

This leads in the same direction as Thomas' recent conclusion:

> "Price varies in importance with both product and types of market. It is never unimportant." (534)

Kothari has pointed to a further aspect of importance, in terms of the visibility and quantifiability of prices and their monitoring by local governments.

Whatever conclusion is reached on the relative importance of non-price factors, it seems unlikely that the price issue ever becomes wholly unimportant.

Export Pricing Complexity

It is frequently argued that pricing internationally increases complexity and risk, for example, by McAlley (376), Seakwood (473), and Arpan:

> "Pricing considerations in international business operations are not only more numerous than those in strictly domestic ones, but are also more ambiguous and risky." ( 24)

The well-known Business International study of international pricing ( 91) discusses these additional complexities in terms of different customer types, variations in local market conditions, the existence of cartels and trade associations and the difficulties in controlling intermediaries.

Similarly, Livingstone (334) points out that pursuing an intellectually sounder approach internationally than cost-plus pricing is dependent on detailed market information, which is likely to be even scarcer for foreign markets than the domestic market. Gabor (196) also highlights the incompleteness of knowledge which appears to characterise export pricing.

At the heart of such claims lies a differentiation between domestic and export pricing, which may be considered further.

### Differences Between Domestic and Export Pricing

As noted above, it is claimed that complexity is greater in export prucing, at least in terms of the number of influential variables, and probably also in terms of less knowledge and information being available.

This complexity is reinforced in the light of suggestions that the major distinction between domestic and export pricing is that demand and competitive conditions vary substantially between markets.

There are claims that export prices may be more flexible than domestic, for example, by Upstone (555) and Silberston (490); that export pricing is tactical and changeable rather than strategic and fixed (353); and that export price requires more adaptation than the other elements of the marketing mix (564). These points are pursued in the context of pricing methods in exporting in 3.3(b) below.

If it is accepted that export price retains importance and that it is differentiated, at least partly, from the domestic price decision by complexity, lack of information and other constraints, then the review may proceed to the more specific issues outlined earlier.

## 3.3(a) EXPORT PRICE LEVELS

This section addresses briefly the issues of firstly, the relationship between domestic and export prices, secondly, the uniform pricing problem, and thirdly, the related question of the link between export prices and world prices.

Export Prices and Domestic Prices

Conceptually, some argue that there is little to support a link between the home market and export price for a product, since as Kahler and Kramer ( 282) and Terpstra ( 532) argue, even if objectives are the same for all markets, the opportunities faced are likely to vary. This is reflected in prescriptive statements like Tookey's:

> "The price charged will also be affected by the nature of the market segment .... Each market will require its own price policy and varying conditions make it unlikely that the firm will be able to charge a uniform price in all markets abroad." ( 539)

However, given the possible constraints discussed earlier on export market information, market spreading versus concentration, and the stage in the firm's internationalisation, it is perhaps worth bearing in mind Muir's pragmatic note (372) that from the firm's point of view, often the first reaction to export pricing will be that it is no different to domestic pricing, and simply to build up from existing domestic price. It appears likely that in such constrained circumstances a link between domestic and export price will normally be found. For example, Rosendale notes:

> "Most firms set about the pricing process for export sales in much the same way as for home sales" (457).

This note should clearly be read in the light of what has already been stated about domestic pricing practices in 2.1 above.

Regarding export price flexibility, some points have already been made in reviewing comparative evidence (in 3.1(d) above). It is perhaps worth noting more specifically here that there are some suggestions that export prices are more flexible than home prices, although residual price stickiness is examined in 3.3(c) below, in relation to exchange rate policy.

In a case study approach, Capon et al ( 94) noted that a less rigid pricing policy was found for export rather than domestic pricing because of international competition, although even then constrained by the need for consistency in multi-market competition with international companies.

In a similar way, although from survey data, Burkhart ( 89 ) claims that export prices in US firms tended to be more flexible than home prices.

In the UK, May ( 353) has suggested that the nature of the price variable has changed in the sense that constraints on price changes in the home market make the variable essentially fixed, while it remains flexible and tactical in exporting.

Rosendale's study argues that there exists what amounts to marginal selling in exporting:

> "most firms were emphatically opposed to the setting of prices in the home market which did not fully cover costs plus a full contribution to overheads .... In export pricing nine firms were prepared to consider and, if necessary, accept such prices." (457)

If evidence of at least some greater flexibility is accepted regarding export pricing, then there is the remaining question of the relationship between home and export price levels.

As noted, Rosendale (457) found some firms prepared to accept business from overseas at a lower price than would be accepted in the home market. Similarly, Livesey (332) suggests that prices tend to be lower in export than in home markets. Gabor (196) argues that there is a case for export price to be lower than domestic, on the grounds that domestic buyers will benefit through the gain of volume scale economies.

Fox and Katz (180) cite survey evidence of 47 UK firms, which found that 51% of the exporters charged higher export prices than domestic, 30% charged lower export prices than domestic and 19% charged the same at home and abroad.

This apparent commoness of charging higher prices overseas may reflect the constraints on the home market postulated by May (353), and further the management attitudes found by Hunt et al (260, 261), Hovell (256), and Hunt (259).

In these studies managers were found to be determined that "the foreigner should not be subsidised" (260), and were reluctant to allocate overheads away from exports (259), and it seemed that the export price charged was commonly the domestic full-cost price plus additions for the extra costs of overseas selling. This may be compared to Gribben's conclusion (220) that differences between home and export prices were largely explained by tariffs and international competition.

These last points come back to the basic issue of the relationship between the home and export price level. Again, evidence is mixed on this issue. There seems substance in the original suggestion made above, that in the absense of other guides the exporter may base export price on domestic price. Indeed, recently Thomas (534) has pointed out that more freely available information (within the EEC) means that export price may have to be based on UK price lists.

However, equally recent studies by Business International ( 92) and Rhys (445) show substantial variation in export prices for the same products in different countries, suggesting at least some degree of market pricing.

This leads to a short examination of the basis for the economist's claim and expectation that prices will be uniform in all markets.

Uniform Pricing

One issue that attracts attention is that related to the earlier more general question of price discrimination, that is whether the exporter should charge the same price in all markets.

Isard (269) points out that the usual prognosis is that commodity arbitrage will lead to each good being uniformly priced throughout the world, although Kressler (313) has noted that the concept of arbitrage is based on substitutability, so that in imperfectly competitive markets there is no rationale for uniform pricing.

Keegan (295) distinguishes three policy options in multi-country pricing: ethnocentric pricing policy, where the same price is charged throughout the world; polycentric pricing policy, where prices are discriminated by market; and geocentric pricing policy, which is essentially a compromise between ethno- and poly-centric.

Taking Keegan as establishing the possible existence of policy choice, it is possible to examine the descriptive evidence and normative writings concerned with uniform pricing.

The BETRO report ( 62) suggested that export prices were usually determined in the UK and were often the same for all markets (which was thought to reflect the typically large market numbers served). A similar conclusion is reached by the more recent ITI report (271). The ITI survey data appear to suggest that half the small British exporters and approximately one-third of the medium and larger exporters charged the same price in all markets, this being a significantly higher proportion than was found with French and German exporters. Duguid and Jaques (150) offered case evidence of uniform pricing being enforced by customer awareness of discrimination, while McAlley has suggested the emergence of a "world price concept", thus eliminating the scope for price differentials (376).

In a US study, Samli (463) found that among major US firms, a large number of the fast growth firms charged the same price in all markets, although no causality could be inferred.

From a normative stance, Kressler (313) notes that uniform pricing is favoured from the legalistic viewpoint to prevent dumping, while from the business viewpoint the desirability of uniform pricing depends on the surrounding circumstances. Keegan (295) suggests that ethnocentric pricing offers the advantages of simplicity and international acceptability, but at the cost of failing to respond to local conditions and opportunities. The Business International report ( 91) on international pricing recognises that a standard worldwide policy may be unavoidable, in the event of there being high customer knowledge.

On the other hand, there appears to be some evidence of non-uniform pricing (as, for example, in the Fox and Katz data cited above).

Isard's paper suggests that the "law of one price" (269) is valid with identical, near-substitute products, but finds that the products he studied exhibited price behaviour marking them as differentiated products.

Similarly, the NEDO report (383) suggests that product differentiation increases the scope for price discrimination.

It is clear that recommendations to exporters to adopt price discrimination between markets are common in the literature.

Day (138) argues that a common price is more likely to be wrong than right with the consequence:

> "If it is too high we fail to get orders. If it is too low an importer or distributor makes an easy profit at our expense."

This is paralleled by Sharman (481), who recognises that the common price is easy to administer and avoids the problem of customer re-sale, but he claims that the advantage of market pricing outweighs this, at least in the larger markets.

De la Torre's well-known paper (541) points to the advantages of using the product life cycle stage differences between markets, as an argument against a single world-wide marketing policy.

Similarly, Weinrauch and Rao (564) have argued that:

> "it is mandatory to have an export marketing mix accomodating the unique aspects of the export environment .... According to exporters, export pricing requires modification to a greater degree than any other factor."

Finally, Keegan (295) notes the advantages of polycentric pricing, in taking advantage of local conditions, although at the possible costs of product arbitrage.

It may be seen that practice varies for a number of reasons, while most management prescriptions favour market rather than uniform pricing. This debate parallels closely the more general issue in 3.1(b) above, regarding the adaptation of the marketing mix by export market, and many of the same findings apply.

World Prices

The points made earlier regarding the flexibility of UK export prices do not permit a general conclusion.

It is perhaps worth noting at this point evidence from Amano (11), Brown (83) and Rosendale (457), which suggests that world prices are significant determinants of export pricing and emphasises the long term importance of price taking in exporting. This is pursued shortly in the examination of export pricing methods.

## Research Objectives and the Hypotheses to be Tested

### Objective 3: Export Price Levels

The third objective for the primary research is to examine the establishment of export price levels for different markets.

From what has been written above, it seems likely that export prices are based directly on UK prices, and this is tested in hypothesis (a).

It seems likely also that in the sample, the majority of companies will conform to the general pattern of charging the same price in all markets, which is tested in hypothesis (b).

Within this category, however, it seems reasonable to hypothesise that differences will exist between sub-groups of exporters. It seems probable that reactive exporters, since they are not wholly dependent on exports may exhibit a tendency to attempt to take advantage of market differences and differentiate between buyers in price.

Of perhaps more central interest is the relationship between export market strategy and price discrimination. It is hypothesised here that firms pursuing market spreading are more likely to charge the same prices in all markets, while firms pursuing market concentration are more likely to charge different prices by market.

Price discrimination, to have a logical basis, implies knowledge of differences in price elasticity, so that it may be that there is a tendency for firms with more market information to discriminate on price more than those firms with little market information.

Finally, it seems reasonable to expect that those firms emphasising price competition in exporting will tend to charge the same price in all markets.

### Hypotheses

3(a) That export prices are based on UK prices.

3(b) That exporters tend to charge the same prices in all export markets.

3(c) That reactive exporters tend to charge different prices in different markets.

3(d) That exporters pursuing market spreading are more likely to charge the same prices in all markets, than firms pursuing market concentration.

3(e) That firms with more market information tend to charge different prices by market and firms with little market information tend to charge the same price in all markets.

3(f) That those exporters rating price highly in exporting will tend to charge the same price in all export markets.

## 3.3(b) EXPORT PRICING METHODS

The objective of this section is to summarise what is known descriptively about the approaches used in price setting by exporters, together with the available prescriptive theories. The attainment of this objective is achieved by using the multi-disciplinary framework of pricing concepts established in 2.1 above.

The discussion here considers views and evidence on the exporter's pricing freedom, cost-based and market-based pricing approaches, and their integration.

### Export Price Freedom

There is some debate as to the degree of pricing discretion open to the exporter, in terms of acting as a price taker or maker.

There is a view that export prices are determined primarily by market and competitive forces. Silberston (490) argues that:

> "In many ways .... exports of manufactured goods exhibit the same price characteristics as primary products, their prices varying with the state of world demand and supply."

In a similar way, Amano ( 11) and Barten and d'Alcantara ( 57) have concluded that world prices contribute significantly to export price determination.

These approaches arise out of the points made earlier regarding the relationship between prices and demand in 2.1 above.

On the other hand, there are suggestions that under modern conditions it is valid to emphasise discretion in pricing (383), particularly in the context of the factors mentioned in the general framework for pricing considered earlier, including the lack of information for decision making, the existence of product differentiation, multi-goal corporate behaviour, the trade-off between price and the other elements of the marketing mix and empirical evidence regarding the impact of oligopolistic market structures, price rigidity and the costs associated with price changes.

Parallels may be drawn between the simple price taking approach and suggestions that export pricing should be seen as quite separate from domestic pricing, for example in May (353), Alfred ( 9 ), Burkhart ( 89) and BETRO ( 62), who claim variously that export prices are more flexible and that any price obtainable above marginal cost should be accepted to gain sales volume to supplement the home market.

Recently, Gabor has written that:

> "The differences between catering to the home market and an overseas market are technical rather than fundamental" (196).

Gabor associates these technical differences with factors like the availability of information and the type and level of competition.

Pursuing the situational concept advanced earlier may offer some opportunity for resolving the price making or price taking dispute in export pricing.

Recently, Ginsburgh and Zang (207) have argued that price taking and price making are pursued by exporters singly and possibly sequentially. This is to say that price taking may be exhibited in one time period (and export prices adjusted to world prices), and price making in another time period (and export prices are based on costs or the domestic full cost price). This reflects the common approach of separating market and cost oriented export pricing, as for example in Kahler and Kramer (282), but goes further in relating these bases to changing circumstances over time.

Once a conditional view is adopted, then it is possible to point to Muir (372), who claims that operationally export price policy depends on the products involved, their availability and the company's objectives, and contrasts undifferentiated, commodity-type products and differentiated, specialty products, which may be compared again to the analysis of price theories offered in 2.1(b) above.

It would seem then that there is some debate as to the pricing discretion open to the exporter, and thus what is implied for the method of price setting used.

Cost Based Export Pricing

There have been suggestions that exporters use full-cost pricing methods to a similar extent that such approaches are used in the home market. Indeed, Robinson (451) argues that most attempts by exporters at standard worldwide pricing involve full-cost approaches.

The BETRO report (62) claimed that most companies used the same method of costing for home and export markets, tending to charge the same cost-based prices in all overseas markets. More recently, McFarlene (378) has reported that the majority of exporters in his survey of Scots Queen's Award winners, used full-cost pricing, so that production costs were the main determinant of prices, although followed by "what the market will bear".

Earlier, Hovell (256) found that the commonest export pricing policy was cost-plus, based either on a sales forecast, or some notion of standard volume or production rate. Cost-based pricing appeared to prevail even when market information was available.

At a similar time, Hunt (259), in studying export management in medium sized engineering firms, found that few companies departed from cost-centred pricing, and that the usual approach was full cost plus. Similar results were reported in Hunt et al (261).

On the other hand, more recently, Hague's study (227) claims that exporting firms were found to work in terms of variable cost and contribution analysis, although it seemed that this was not followed in reacting to devaluation, and Hague notes that certain of the cost calculations used were misleading, in any case. Silberston (490) has claimed that marginal approaches are more common in exporting than the domestic market, although the recent Barclays Bank report notes that:

> "Having a uniform and simple costing system, the French and British seldom employ marginal costing." (271)

This is apparently in contrast to the practices of medium sized and larger German exporters.

In export a pricing method which may be related to the full cost approach, is that of basing export prices on domestic prices, as noted in 3.3(a) above.

Predictably, this practice is criticised on the grounds of arbitrariness, in the same way that many criticise cost-plus pricing in general, and on the grounds of ignoring the demand differences between markets, for example, by Kahler and Kramer (282) and Business International (91).

Terpstra (532) argues that export prices may justifiably be higher, lower or the same as domestic prices, depending on demand conditions, although as noted, others have found exporters sometimes reluctant to price exports below domestic price levels, which is echoed in Sharman (481) and Slijper (504).

In this present context, the use of domestic price as base is compared directly to full cost pricing in domestic decisions.

Following the logic of the pricing framework established earlier, it is clear that many argue that full cost approaches are unsatisfactory in exporting and advocate marginal or incremental analysis.

The Business International study (91) on international pricing rules out the unified, cost-based approach as unacceptable, while Root (455) in his widely-quoted paper on export pricing strategy, criticises the use of cost-plus on just the same grounds that it is criticised in the home market: ignoring demand and competition, arbitrary cost allocations and the circularity of reasoning involved. Similarly, Keegan (295) claims that the common use of cost-plus has an undesirable impact:

> "The typical effect of this cost-plus pricing approach in export marketing is a final price which is completely out of line with competitive conditions".

Keegan is willing to conceed the role of cost-plus in some circumstances, in the same way as Dean:

> "Cost-plus pricing is justified only if the cost of information about demand and the administrative cost of applying a demand-based pricing policy exceed the profit contribution obtained by applying these approaches." (295)

More recently, Moustapha (371) has recognised the attraction to the exporter of full-cost pricing on the grounds of justifiable prices, speed and ease, but criticises and ultimately rejects it for the usual reasons.

Again, in parallel with the more general framework offered in 2.1 above, many recommend marginal or incremental approaches to export pricing. Indeed, the advocacy of the incremental approach is probably commoner in exporting.

Alfred ( 9) makes a case for selling in export markets at any price above marginal cost, while Day (138) and Sharman (481), for example, put forward a strong argument for "marginal selling" in exporting, in the absense of the opportunity to earn more by taking other actions. Muir (372) and Slijper (504) advocate marginal cost export pricing as long as this does not pull down prices in major markets, or lead to accusations of dumping.

Davies (135) is a supporter of the incremental or marginal approach to pricing and claims that:

> "By adopting this approach the competitiveness of British industry in the export markets would be increased. Our competitors have been applying it to the pricing of their exports for many years in a more widespread manner than ours and this has helped enormously in their ability to outsell us."

The advocacy of marginal approaches is frequently related to a market oriented pricing basis, for example, Moustapha points out:

> "The maximum price is not a matter of cost but of competition and extent of demand. The minimum price, however, is set by total variable costs .... To say that either the direct-costing method or the full-cost method provides the best guide to pricing decisions is a dangerous oversimplification."(371)

Moustapha's argument is that while export business is a small proportion of the total, then direct costing and contribution analysis approaches are the more relevant, while, as the importance of exporting increases, then the more relevant approach is that of incremental costs, since:

> "the conclusion that all variable costs are relevant and all fixed costs are irrelevant is far from being foolproof." (371)

It might, of course, be argued that this case rests on the assumption that exports are costed and priced differently to domestic business, which may be said to be far from proven in the case of the UK.

Broadly, it can be seen that the cost arguments in export pricing parallel for the most part the more general ones advanced earlier, with perhaps some differentiation related to the dominance of exports as a proportion of the total business of a firm, and the use of domestic price as a base for export prices.

Market Based Export Pricing

While it is argued by some that export prices conform to the normal cost model and that exporters pursue cost-oriented policies (at least some of the time (207)), others claim that export prices are determined primarily by demand and competition, for example Amano ( 11), Barten and d'Alcantara ( 57) Kahler and Kramer (282) and others point to the impact of world prices on export prices.

Following the logic of the general pricing framework, there is interest in the responsiveness of export prices to demand (as discussed earlier in 3.1(d)) and the competitive interaction taking place.

Duguid and Jaques (150) in their case analysis of eleven companies claimed that:

> "Most of the companies found it necessary and desirable to adjust their prices according to market conditions".

More recently, Government research has suggested:

> "There is evidence in recent years that UK exporters have become more inclined to follow the price charged by competitors in world markets." (157)

It has, however, been noted that some researchers suggest that UK exporters charge the same in all overseas markets ( 62, 271).

Certainly, most export authorities prescribe pricing to individual markets, for example Sharman (481), Day (138), Terpstra (532) and Tookey (538), although the BETRO report ( 62) notes the difficulties in such an approach in the case of firms pursuing market spreading, or at least in the absense of market concentration of some form.

In terms of competitive influences, a study by Artus ( 25) claims that competitors' prices play a crucial role in the pricing decisions of French, German and Japanese exporters, while British and American export prices are far less determined by competitors' prices.

Similarly, as discussed in 3.1(d) it has been suggested by various sources, for example Cooper et al (117) and Ray (441), that UK export prices are thought to be less responsive to demand or competitive conditions.

More recently, there have been claims that UK exporters are more willing to price competitively (mainly in the floatation period), for example by IMR (263), ITI (271) and Suntook (524), who notes a "growing inclination" for British firms to follow competitors' prices.

It seems necessary to compare this to the earlier comments on the adaptation of cost based prices to market conditions (see 2.1(c)) or to the argument that exporters are either price takers or makers at any given point and that this may determine the prevailing determinant of price.

## Integrative Views of Export Pricing

Inevitably, in any consideration of pricing the discussion returns to the inter-disciplinary concept introduced earlier, as reflected by Davies (135), Weinstein (565) and Business International (91), accepting possibly an iterative mode leading to the final price charged, or possibly the Ginsburgh and Zang argument (207) that export prices arise from the comparison between the domestic, cost based price and competitors' prices, the result depending on market structure.

## Research Objectives and the Hypotheses to be Tested

### Objective 4: Export Price Methods

The fourth primary research objective in this study is to examine the pricing methods used for export.

From what has been written in this section of the paper, together with the earlier, fuller consideration of the general pricing model in 2.1, it seems reasonable to suppose that exporters will normally pursue full-cost pricing methods - hypothesis (a).

It may be that this hypothesis will be rejected on the grounds that the exporters concerned are price takers and that world prices provide the major determinant of price. Later hypotheses attempt to distinguish between exporters in terms of the dominant price determinant.

Further, in terms of the basic mechanics of export pricing, it seems likely from the available evidence that export prices are derived in the same way as domestic prices, and indeed may simply be based on domestic prices - hypothesis (b).

Since full cost and similar (here "domestic price-plus")methods are normally defended in terms of safeguarding overhead recovery and profitability, it seems likely that those exporters claiming to pursue profit objectives in export will be more likely to use cost-based methods, while those aiming at volume objectives will be more likely to use market-based methods - hypothesis (c).

Regarding the motivation for export, arguments could be made in either direction: that active exporters use market-based pricing for maximum export penetration, or that they use cost-based methods to ensure profitability and for the other apparent attractions of cost-plus pricing. Here it is hypothesised that active exporters will tend to use cost-based methods, in view of their commitment to export and the possible need to justify prices, while reactive exporters, with less at stake in export will adopt market-based pricing in the sense of charging as much as the market will bear - hypothesis (d).

In terms of strategy, the logical hypothesis for testing is easier to formulate. Where firms concentrate on key markets, it is suggested that their pricing will usually be specialised by market. There may be counter-arguments to this, for example arising from the legal problems in discrimination, but it appears to conform with the general logic discussed in the earlier parts of this paper. On the other hand, it is argued, primarily on logistic grounds, that market spreading firms cannot use market-based pricing and so presumably use cost-based methods. This proposition is tested in hypothesis (e).

The commonest defence of cost-based pricing is that it offers a systematic approach in the absense of information on demand and competition. It appears logical then to hypothesise that in the export field, those firms with little market information will tend to use cost-based pricing methods and those with greater levels of information are more likely to use market-based methods - hypothesis (f).

Lastly, it seems reasonable to suppose that those firms claiming that price is the most important marketing weapon in exporting will use market-based pricing methods more than firms competing on non-price grounds - (g).

Hypotheses

4(a) That exporters normally use full-cost pricing methods.

4(b) That exporters use the same pricing methods in domestic and export markets.

4(c) That exporters pursuing profit objectives in export tend to use cost-based methods of pricing and exporters pursuing volume objectives tend to use market-based methods.

4(d) That active exporters tend to use cost-based pricing methods and reactive exporters tend to use market-based methods.

4(e) That firms pursuing market spreading are more likely to use cost-based pricing methods and firms pursuing market concentration are more likely to use market-based methods.

4(f) That firms with more market information tend to use market-based pricing methods and firms with less market information tend to use cost-based methods.

4(g) That firms rating price highly in exporting will tend to use market-based methods of pricing and those rating price low will tend to use cost-based methods of pricing.

## 3.3(c) THE IMPACT OF DEVALUATION AND FLOATATION ON EXPORT PRICING

This section aims to provide a review of the effect on export pricing of currency changes in the form of devaluation and floatation, and to examine the empirical evidence relating to these effects.

The discussion is divided into five parts: the first examines the responses of export decision makers to devaluation and floatation, and the second considers the impact of export prices on trade volumes. Closely related to these points is the issue of the effectiveness of price as opposed to non-price forms of competition, and finally it is necessary to examine the indirect effects on prices of factors like devaluation related cost changes and the pressure towards price stability.

### Responses of Exporters to Sterling Devaluation and Floatation

The devaluation and later floatation of currencies is frequently assumed to improve a country's export price competitiveness, as argued recently by various writers, for example (113, 114, 223, 224) among others. An earlier part of this paper summarised reservations about the validity of this assumption about international competitiveness (see 3.1(d) above) and there appear grounds for at least qualifying the basic assumption.

A recent NEDO report (383) has argued that the traditional view which predicts improved price competitiveness following devaluation is unrealistic, since while that traditional analysis concentrates on price effects, the complexity of the price decision and the influences on it mean that prediction of the reaction to devaluation is far less certain. The essence of this non-price competition argument is that prices are unlikely to adjust mechanically to exchange rate changes, because of the differentiation of products, the existence of multi-product and multi-national companies, managerial discretion in pricing in oligopoly and the possible impact of price leadership and price discrimination. Further, it is argued that supply side rigidities may make it unlikely that demand stimulated by increased price competitiveness could be satisfied.

Similarly, Clague and Grossfield have claimed that:

> "responses to floating rates will vary greatly, depending on such things as industry practice, sensitivity to price changes and the alternatives open to the customer." (104)

In the same way, Sharman (481) argues that response to currency changes will be determined by the firm's perceived ability to take more business, expected competitive reactions, and how long-term currency effects are thought to be. This last point is of particular significance in the context of floatation as opposed to the devaluation of fixed rates.

One argument advanced here is that the impact of currency changes is felt on export profits, if it is the case that prices are not to be reduced for competitive, strategic or other reasons (383). Rosendale (457) has claimed that this is the case where British exporters are price makers and market pressure keeps competitors' prices to the British level. For different reasons, to be discussed below, Dunn (151) also argues that exporters will act to stabilise prices and absorb exchange rate changes in profits. Artus (25) gives further voice to the price stability argument, through the claim that exporters seek to avoid sudden price changes relative to their competitors. It is noteworthy that in Hovell's study of export decision making (256), none of the firms contacted had increased prices to gain financial benefits from currency changes, since they were apparently seeking to avoid price changes. This stability issue is considered further shortly. Certainly, recent Treasury opinion is that UK exporters are tending to follow their competitors' prices more than in the past, and:

> "This carries the implication that changes in exchange rates are more likely to affect profit margins than export prices." (157)

In parallel with the stability argument should be considered the time dimension. Junz and Rhomberg (279) decompose the delay in response to exchange rate changes into those lags associated with recognition, decision, delivery, replacement and production. It is perhaps valid to compare the first two of these with the managerial discretion in response, while the others are of a more logistic nature.

Finally, as argued by Baron ( 52) and Page (410), the impact of exchange rate changes is mediated by the invoice currency choices pursued by firms, which provides the subject of the next section of the paper.

<u>The Effects of Devaluation and Floatation on Export Prices</u>

The debate here is as to the degree to which export prices react to currency changes, while the next section is concerned with the impact of currency changes on export volumes and market shares.

On the one hand there is a body of evidence which appears to suggest that export prices move in the manner predicted by traditional economic analysis.

For example, Isard (269, 270) has concluded that exchange rate movements are associated with substantial short-run changes in relative prices for all the industrial categories he considered, and that in most cases a major share of this price change persisted for a number of years.

Similarly, Artus ( 25) has claimed that export contract prices are affected rapidly by exchange rate changes, and that for most countries the exchange rate impact on price was greater than the medium-term impact on the costs of production.

Case material offering support of a kind is provided by Hague et al ( 227), who found situations where UK exporters were forced to reduce prices more than they wished by customers whose own currencies did not follow Sterling in the 1967 devaluation, amounting in some cases to "devaluation hysteria", enforced through bilateral oligopoly.

More qualified conclusions have been reached by others. Gooding (213) has suggested that gains from exchange rates are balanced by the effects on costs. Others, for example Artus and Sosa ( 27), find support for the contention that export prices change in relation to exchange rates, but that these price effects are not large and tend to be felt slowly. Artus ( 26) claimed that the 1967 devaluation of Sterling had beneficial effects on trade, but that the specific effect on prices was less clear.

On the other hand, doubts have been expressed recently regarding the price adjustment process. The NEDO report (383) claims that the costs and dangers in price changes are such that prices are unlikely to adjust mechanically to exchange rate changes, as the price decision is more complex and discretionary than traditional analysis allows.

A similar, though empirically based, argument is advanced by Dunn (151), who claims that the normal assumption that export prices change because of exchange rate movements is based on the assumption of perfect competition, which is often false.

Rosendale (457), for example, points out that where a British exporter is a price leader, then competitors are likely to follow any price changes, making them less attractive, at least as far as price reductions are concerned.

Fox and Katz (180) have argued that the real linkages between production costs, exchange rate changes and end-user prices are not clear, and most importantly here, that final prices are influenced by factors which outweigh exchange rate effects, as in the case of negotiated prices or in price leadership.

This suggests conflicting evidence and argument regarding the real reaction of export prices to exchange rate changes in devaluation or floatation.

## The Effects of Devaluation and Floatation on Export Volumes and Market Shares

The debate on whether or not export prices react in the traditionally predicted manner to exchange rate changes, largely determines the conclusions reached about the effects of exchange rate changes on export volumes and market shares. However, this argument must go further to recognise the elasticity issue if prices do change, and later the effects of exchange rate changes on non-price competition.

Artus ( 26) claims that the 1967 Sterling devaluation had a large and favourable effect on UK export trade, evidenced through a large expansion in volume. Similarly, a more recent study by Artus and Sosa ( 27) in 1978, found that in the market for nonelectrical machinery, changes in relative prices between UK, USA and West Germany had a significant effect on market shares.

Earlier, in 1974, Deppler (144) in studying exports by France, Germany, Netherlands and UK, found that exchange rate changes led to substantial changes in export volumes in the expected directions (although with the interesting exception of West Germany).

Further, in 1976, Goldstein and Khan (212) found that import demand was responsive to relative prices for eight of the twelve countries they studied, regardless of the size of relative price changes, and Kreinin (312) claims that his results verify the existence of a high elasticity of demand internationally for manufactures.

As noted earlier, Junz and Rhomberg (279) have concluded that exchange rate originated price effects of floatation are associated with changes in trade flows, but that this takes place over a longer time period than has generally been assumed.

In assessing fixed exchange rate changes, Page (411) has attempted to establish what exports would have been in the absense of devaluation, and finds that countries with large rate changes benefitted and suffered as would be expected under traditional analysis. It is particularly noteworthy that Page found smaller changes less predictable, since it is clear that floatation (with which her work was not concerned) normally consists of relatively small rate changes.

In his case research, Hague et al (227) found that nearly all the firms studied had increased exports after the 1967 devaluation.

The counter-arguments consist firstly, of claims that price changes do not produce large volume changes because of low price elasticity of demand, and secondly, of claims that floatation and devaluation do not cause price changes, although admittedly other effects related to currency changes may influence the volume of trade.

In the first of these categories can be placed Whitman's "elasticity pessimism" (571), which arises from the apparent failure of large exchange rate changes and relative price changes to significantly affect trade balances. Related to this, there have been claims such as that by Gooding (213), that in 1977 a lack of economic activity meant that low prices were of little assistance to British exporters.

The most concentrated attack in this area is contained in the NEDO paper "International Price Competitiveness, Non-Price Factors and Export Performance" (383). The suggestion that prices may not in any case respond to exchange rate movements has already been considered, but the authors of the NEDO paper go further and make a case for the contention that price is only one determinant of volume and market share, which ultimately depend on the effectiveness of a complete marketing strategy. It is this argument regarding non-price aspects of competition which appears most damaging to the robustness of traditional analysis, and will form the next elements of this argument. In addition, it is pointed out that if price elasticity is low, there may be little volume gain in reducing export prices and that competitors' prices may be bid downwards with no gain in volume to any competitor. If the argument is accepted that sales may be sensitive to factors other than price, this itself severely damages the underlying assumptions of how exporters should act in currency floatation.

It is, however, also argued that currency devaluation may benefit exporters through increasing profits ( 62,383 ), although there appears little evidence that this has stimulated UK firms to compete more through non-price variables in the predicted way, the proposition being that additional profit should fund extra marketing expenditures (481).

Exchange Rate Changes and Non-Price Competition

The nature, power and comparative advantage of non-price competition have been discussed in 3.1(d) above. This discussion now becomes of central interest in analysing the impact of currency movements on competition.

Gooding (213) has argued that devaluation and floatation have not increased competitiveness because the UK's main competitors are ahead in terms of non-price competition. The NEDO report (383) concurs in this argument, citing evidence that UK goods (in engineering) are less attractive than those of competitors. Earlier work by Hovell (256) in the same industry also suggested that the common assumption that exports were primarily price sensitive was, at best, oversimplified. Carvel (96) on leaving the Price Commission, has commented on the contrast between UK firms' claims that price competition is inefficient in the domestic market for manufactures, but essential to success in exporting.

Armington ( 22) has pointed out that while the Deutschmark has floated up against most other currencies, German exports appear not to have suffered, which leads to the suggestion that strength in non-price variables reduces or avoids the impact of exchange rate changes. That such strength exists for Germany has been confirmed by Artus and Sosa, among others:

> "The relatively low price elasticity for German exports tends to substantiate the widespread belief that nonprice factors play an important role in determining the demand for German goods." ( 27)

Further statistical evidence analysed by Deppler (144) suggests that German export market shares have not suffered from revaluation effects, at least since those of 1961.

Similarly, Fox and Katz have claimed that:

> "it should be recognised that floating has not restored US competitiveness vis-a-vis Japan and Germany." (180)

The grounds for this were that only a small proportion of the country's exports appeared to be sensitive to price competition.

The NEDO report (383) argues strongly that differentiated products compete on non-price grounds, and that the UK's lack of competitiveness may be traced to product inferiority rather than price disadvantage. Indeed, it is possible that price competition may lead the UK down-market. It is perhaps interesting to consider whether such a trend may be related to UK exporters claims in the recent IMR surveys (263,264 ) that price was their major competitive disadvantage, even though these claims were made at a time when the pound had floated down over a substantial time period. This may be particularly relevant in the light of Tessler's claims ( 533) that currency movements encourage and invite firms to compete on price while other countries take a price premium.

As far as comparisons are worthwhile, it is perhaps worth observing Junz and Rhomberg's contention (279) that there is a trend generally to reduced dependence on price competition, particularly in view of the type of case material cited by Tessler (533) and ITI (271) to illustrate the risks involved in price cutting.

There seems then considerable argument that devaluation and floatation may not influence competitiveness in the way of the traditional analysis, although some suggest that the effect felt through improved export profitability may bring about increased non-price competitiveness, albeit that there is no empirical evidence to support this for the UK.

Exchange Rate Changes and Price Stability

There is frequently an assumption that devaluation or floatation brings about export price changes, and this may be frustrated by the price rigidity or stability discussed as a general concept in 2.1(b) above.

Artus (25) argues that firms may try to achieve competitive stability, for the types of marketing reasons suggested by ITI (271), and the avoidance of the adjustment costs associated with price changes by Ip (268). Certainly, Hovell's case work in engineering (256) suggested that firms avoided price changes internationally, except when their costs changed.

Dunn (151) points out that oligopolists get stable prices through local currency invoicing, confirming the BETRO (62) and NEDO (383) comments on the effects of devaluation being of a profit rather than a price reduction nature.

Related to this is the practical point advanced by many that any advantage from currency movements may in reality be absorbed by agents and distributors, rather than benefitting the UK exporter (180, 213, 383).

Effective Exchange Rates

A last point worthy of attention on this issue is concerned with the real impact of floatation on the individual company. Accepting that the company is affected by many surrounding problems, one effect of market spreading is that the weighted average movement of the pound, allowing for the varying balances of trade with different markets, may differ substantially from the national average floatation and may differ substantially between companies. In other words, the "effective" company devaluation or revaluation may be significant to the impact of currency movements on the firm, the management perception of that impact, and ultimately the reaction of the firm.

## 3.3(d) THE INVOICE CURRENCY DECISION

### The Structure of the Currency Choice Decision

The choice of invoice currency is of significance from both the macro and micro points of view. For example, Page (410) has pointed out that this decision is one of the key determinants of the total impact on the economy of exchange rate changes, and, as will be seen shortly, a number of authorities agree that it may be central to the individual company's export profitability.

It has been argued earlier that exporting involves the acceptance of higher levels of uncertainty and risk, than domestic marketing, or at the very least different types of risk. This is reflected, for example in Muir's comments about avoiding risks in exporting (372). Clearly, the invoice currency decision is particularly associated with risks involved in changing exchange rates, although it may be related also to contract duration risks (in the sense of increased exposure to exchange risk), and overseas trading risks (in the sense of bad debts, or late payment for example).

Most particularly, in the context of the immediately preceding section of the paper, the impact on the firm of exchange rate changes will be mediated by the currency of invoicing, as argued by Gooding (213), who points out that there is a danger of oversimplifying the benefits of floatation, by ignoring the practical aspects of reactions to currency rate changes at the company level.

The options open to the exporter, at least theoretically, in currency strategy have been delineated by various writers, for example Gooding (213), Baron ( 52, 53 ), Goldstein (211), Hovell (256), Kahler and Kramer (282), Midland Bank (359), Muir (372), Paulden (424), Sharman (481) and Terpstra (532). The options and their characteristics are discussed below, around the issues of currency choice, the various advantages to exporters and importers, the corresponding disadvantages, and the possible reactions to exchange rate changes.

(a) Currency Choice

Kahler and Kramer, among others, distinguish the choice faced as being between the exporter invoicing in his own currency, invoicing in the importer's currency, or invoicing in the currency of a third country.

(b) Exporter Advantages and Disadvantages

Firstly, there is the case of invoicing in the exporter's currency. Kahler and Kramer point out that invoicing in the exporter's currency offers the advantages of reduced foreign exchange risk (in the sense that there is no exposure) and the ability to measure profits quickly, since all sales are in the same currency. Some suggest that this is the appropriate course for the manufacturing firm on the grounds that it should avoid involvement in speculation on currencies. To this may be added the appealing appearance of simplicity, as noted by Muir.
In this situation, if the value of the exporter's currency falls (all other things being equal) then the importer's price in local currency is effectively less, and correspondingly, if the exporter's currency rises, then the importer's price in local currency rises. Thus, the exporter bears a demand risk.

Secondly, there is the case of local currency invoicing. There are advantages noted here in meeting local customer preferences (282 ), but the major attraction lies in the potential benefit if the exporter's currency floats down against the local currency, in which case, if the local currency price remains unchanged, the exporter's apparent income in his own currency increases. Naturally, the corresponding disadvantage to the exporter is that if his own currency moves up against the importer's, then his own-currency income falls. In other words, the exchange rate risk is borne by the exporter. Baron points out that in this case total revenue is exposed, although Paulden and others argue that this may be off-set by the use of forward cover, as discussed in 3.2(d) above.

(c) Importer Advantages and Disadvantages

Kahler and Kramer point out that there may be some advantage for the importer in receiving invoices in the exporter's currency, if the importer anticipates a foreign exchange gain, or if a lower price can be negotiated in return for accepting the foreign exchange risk. The corresponding risk for the importer is that if his currency weakens against the exporter's, this produces an effective price increase in the local currency.

There are various attractions for the importer of being invoiced in his own local currency: a lower level of risk, profits are measured quickly, resale prices are clearer easier, competitive comparisons are facilitated, prices are stable irrespective of currency movements, and procedures are generally simplified (271, 359, 372, 532, 282).

<u>(d) Reactions to Exchange Rate Changes</u>

In the event of a relative fall in the value of Sterling, Hovell identifies the options faced by the Sterling-invoicer as:

(1) increase Sterling prices proportional to the exchange rate change, so that local currency prices remain constant,
(2) maintain the Sterling price at its old level, thus reducing the local currency price to the importer,
(3) a compromise between (1) and (2).

On the other hand, for the exporter invoicing in local currency, the choices are:

(1) maintain the local currency price, thus gaining an increased Sterling income,
(2) reduce the local currency price by the amount of the Sterling devaluation, giving the same Sterling income,
(3) a compromise between (1) and (2).

Conversely, in the less discussed case, until recently, of Sterling floating up relative to the importer currency, the choices are reversed.

These points are summarised in Table 3, below.

Having delineated the theoretical choices open, the next stage is to examine the strategies recommended by the prescriptive authorities, the evidence of present practice in industry, and what is known about the determinants of the choices made.

TABLE 3 INVOICE CURRENCY STRATEGIES

| | Invoice in Sterling | Invoice in local currency | Invoice in a third currency |
|---|---|---|---|
| **Exporter** | | | |
| Advantages | Reduced transaction risk<br>Stable Sterling income<br>Simplicity<br>Avoids currency speculation | Local price list stability<br>Potential gains if Sterling is weak | Stability |
| Disadvantages | Demand risk | Exchange risk | |
| **Importer** | | | |
| Advantages | Potential gains if Sterling is weak | Stable price lists<br>Avoids exchange risk<br>Simplicity | Stability |
| Disadvantages | Potential loss if Sterling is strong | Loss of potential gain through weak Sterling | |
| **Exporter Choices** | | | |
| If Sterling floats down | (1) Increase £ prices proportional to the rate change, to keep the local currency price at the old level,<br>(2) Maintain the £ price at the old level, giving a reduced local currency price to the importer,<br>(3) Compromise. | (1) Maintain local currency price, to gain increased £ income,<br>(2) Reduce local currency price and receive the same £ income,<br>(3) Compromise. | |
| If Sterling floats up | (1) Reduce £ prices proportional to the rate change, to maintain the local currency price at the old level,<br>(2) Maintain the £ price at the old level, giving an increased local currency price to the importer, | (1) Maintain local currency price and accept reduced £ income,<br>(2) Increase the local currency price and receive the same £ income, | |

Invoice Currency Strategy

There is a considerable degree of consensus among contemporary writers on this issue, leading to a wealth of prescriptions to exporters to invoice in foreign currencies, and in many cases to reduce speculative risks by covering forward, as discussed in 3.2(d) above.

One approach recommends that exporters should invoice in local currencies of the markets to which they sell, as argued for example, by Day (138), Sharman (481) and Syrett (527) among others. This prescription is defended firstly, in terms of the general advantages seen in invoicing in currencies other than Sterling, but secondly, in terms of meeting customer and importer preferences for quotations and prices in their own currencies.

A second approach shares the first of these justifications, but not universally the latter. This is to say that some prescribe invoicing in a stable or appreciating currency, usually again with the recommendation of taking forward cover. By implication this form of argument leads to the questions of a possible situational choice between Sterling and local currency invoicing depending on their relative strengths, perhaps leading to a policy of mixed currency invoicing, using Sterling in some markets and local currencies in others, and the question of third currency invoicing.

This type of viewpoint may be found in Barnes ( 49), Hague (227), Paulden (420, 421, 423, 424), Rule (459), and Upstone (555).

It would seem that there is some agreement that UK exporters should invoice in foreign currencies, at least where they are stronger than Sterling, and that forward cover offers advantages in reducing exchange as opposed to demand risks.

This essentially prescriptive theory may be contrasted with the available empirical evidence regarding industrial practice.

Empirical Evidence on Invoice Currency Practice

This evidence may be divided into that concerned with the UK and that with other countries.

(a) UK Practice

Reid has noted:

> "Traditionally British companies have exported in Sterling" (442).

The Barclays Bank report suggests that:

> "Since the bulk of the world's trade up to the 1950's was still conducted in Sterling, exporters from Britain had little incentive to change existing methods." (271)

Even accepting Reid's statement that there are increasing moves towards foreign currency invoicing (and the use of forward cover), the present position remains as observed by Paulden:

> "it is astonishing so few British exporters quote in foreign currency .... no more than one in ten quotes in anything but sterling." (424)

The validity of these comments may be assessed in the light of both case and statistical evidence.

Firstly, there are various specific cases of large company practice available. It has been reported that the P & O shipping group has moved from Sterling to \$US invoicing since the floatation of currency (442). Similarly, GEC has traditionally been a seller in Sterling, but since 1974 has found hard currency payments more attractive. GKN still priced 70% of its exports in Sterling in 1976, although preferring long-term contracts to be in harder currencies, while at the same time Lucas was still quoting in Sterling, although increasingly preferring foreign currency (442). At the other extreme, ICI invoices 70% of its exports in foreign currencies (mainly the importers') (224, 442) and BP conforms to world practice by invoicing most petrochemicals and oil in \$US (224).

At a smaller scale, Lethbridge and Tylee (331) have studied J.A. Robertson, a Scottish knitwear company, which felt unable to fix its prices in local currencies, in spite of exporting 90% of its production.

Recently, in compiling fifteen detailed case studies in exporting, Thomas has concluded:

> "A feature on which no clear picture emerges, however, is in which currency prices are quoted having regard to fluctuating exchange rates." (534)

Secondly, it is possible to examine the patterns revealed by survey evidence and secondary statistical evidence.

A recent Midland Bank paper (360) commented that in the 1970's British companies have seen the increased need for contracting in foreign currencies, citing in support the Department of Industry statistics which are to be discussed shortly.

Similarly, Paulden (424) claims that the proportion of British exports invoiced in foreign currency increased from 8% to 20% between 1975 and 1977, pointing to bank evidence that Britain pays 92% of its import invoices in foreign currency but quotes 80% of its exports in Sterling.

Barnes ( 49) in 1971 quoted similar proportions, claiming that BOTB figures showed that 27% of exports were invoiced in foreign currency.

Golder (209) confirms the apparent trend towards invoicing in non-Sterling currencies during the period of high UK inflation in the early and mid-1970's.

A study by Wood and Carse in 1976 (583), reported that 81% of exports were invoiced in Sterling, on the basis of their survey, and that when foreign currency was used, it was normally the buyer's. It was also found that the use of the forward market was infrequent, since only 11% of transactions invoiced in foreign currency were covered forward. The finding that the bulk of UK exports were invoiced in Sterling was contrasted with the parallel conclusion that 92% of imports were invoiced in foreign currencies.

A similar, though more limited, approach taken by Rule (459), involved a study of 17 large exporters in 1977, when it was found that 50% billed in Sterling, 30% in $US and 20% in the importer's currency. There may be some suggestion in this example, that larger exporters may be more likely to invoice in foreign currencies.

This is partly confirmed by a NIER paper in 1977, which found that exporters tended to prefer invoicing in their own currencies and tried to enforce this in the negotiation of terms of contract.

In 1978, McFarlene's study of successful Scottish exporters, winners of the Queen's Award for Export Achievement, found that quotations were mainly in Sterling, although there were some moves towards local currency invoicing (378).

In the same year, an IMR study of British exporting found that 75% of the exporters surveyed sought payment in Sterling, the only major exception being in sales to the USA. These figures are given in Appendix V.

A third source of evidence, in addition to the above case material and survey results, is provided by the statistical data produced by a series of six-monthly Department of Industry surveys of samples of export invoices (543, 544, 545, 546, 547 and 548).

Broadly, these data suggest some increases in the proportion of exports (by value) invoiced in foreign currencies, although most recently this proportion has fallen back, mainly through a reduction in invoicing in US dollars, but also through a fall in local currency invoicing.

A summary of these figures is given in Table 4 below, and the detailed figures are in Appendix IV.

TABLE 4

UK EXPORTS INVOICED IN FOREIGN CURRENCIES

| Sources: | Early estimates (543) | April 1976 (544) | Oct/Nov 1976 (545) | May 1977 (545) | Nov 1977 (546) | April 1978 (547) | Oct 1978 (548) |
|---|---|---|---|---|---|---|---|
| % of invoices in Sterling (by value) | 85-90% | 80% | 73% | 70% | 69% | 71% | 75% |
| % of invoices in foreign currencies | 10-15% | 20% | 27% | 30% | 31% | 29% | 25% |
| Whereof: | | | | | | | |
| in importers' currencies | - | 12% | 15% | 15% | 12% | 12% | 11% |
| in US $ | - | 8% | 12% | 14% | 17% | 16% | 13% |
| in other foreign currencies | - | - | - | 1% | 2% | 1% | 1% |

While admitting that certain crudities exist in these data, notably that Sterling transfers to overseas subsidiaries are included, they do seem to confirm, firstly, that still a relatively small proportion of exports is invoiced in foreign currencies, and after some increases in the most recent periods for which data are available this proportion has fallen.

It is perhaps worth noting that some of the earlier increase may have resulted from increased awareness among exporters, but it is likely also to have reflected the official requirement imposed in 1976 that many major capital contracts financed with official support should be contracted in foreign currencies (360).

These figures further analysed suggest various differences within the overall pattern.

Foreign currency invoicing appears predictably more common with large exporters (defined for the statistical series as having export sales greater than £25 millions in 1975) and in the case of large transactions, although in both cases the data show some variability. The data are shown in Table 5 below.

TABLE 5

EXPORT INVOICE CURRENCIES BY EXPORTER AND TRANSACTION SIZE

| | % OF INVOICES IN FOREIGN CURRENCY (BY VALUE) | | | |
|---|---|---|---|---|
| | May 1977 | Nov 1977 | April 1978 | Oct 1978 |
| Sources: | (545) | (546) | (547) | (548) |
| EXPORTER SIZE | | | | |
| Small exporters | 27% | 24% | 26% | 21% |
| Large exporters | 40% | 50% | 39% | 36% |
| All exporters | 30% | 31% | 29% | 25% |
| TRANSACTION SIZE | | | | |
| Up to £2,500 | 18% | 18% | 16% | 15% |
| £2,501 - £20,000 | 24% | 27% | 23% | 23% |
| £20,000 - £250,000 | 28% | 23% | 25% | 25% |
| Over £250,000 | 45% | 52% | 47% | 31% |
| All transactions | 30% | 31% | 29% | 25% |

It seems likely that the large fluctuations in the figures for larger exporters and larger transactions reflect the impact of very large contracts on the total samples taken.

Further to this, the geographical analysis of the data suggests the relatively greater importance of local currency invoicing in Western Europe, and the importance of $US invoicing, partly as a local currency in selling to the USA, but also as a third country currency for exports to Western Europe, the oil exporting countries and Japan.

The empirical evidence would thus seem to indicate that a relatively small proportion of invoices are in foreign currencies, although this proportion has varied over the period under study. There is some evidence that larger exporters tend to invoice more often in foreign currencies, although the cases cited show mixed behaviour even here. It seems that foreign currency invoice practice varies substantially between markets, being particularly common in Western Europe, USA and Japan.

(b) International Practice

The comments already quoted regarding the contrast between the use of Sterling by UK exporters and the use of foreign currencies by those selling to the UK, support the contention that the pattern emerging internationally is that described by Grassman (218) as "a fundamental symmetry in international payments patterns", whereby exporters tend to favour invoicing in their own currencies.

In the case of West Germany, recent IMR survey data (265) describing German exporters found that almost all required payment to be made in Deutschmarks, which was compared to the finding that three-quarters of British exporters invoiced in Sterling.

This appears consistent with earlier work by Gehrmann et al (202), which found that in 1976 87% of German export trade was carried out in Deutschmarks. It was also noteworthy that there was fairly extensive use made of forward cover. This finding was also supported by Grassman in a later, larger comparative study (216, 217, 218).

Grassman's studies in 1968 (217, 218) and 1973 (216) in Sweden showed that Swedish Krone were used in 75% of exports, and found a general rule that transactions were dominated by the seller's currency, which was reversed only in Swedish trade with USA, UK and inconvertible currency countries. Over the five year period, the currency pattern appeared stable. It was also noted that only a small fraction of foreign trade transactions were covered forward.

The general finding on exporter own-currency dominance was supported by Grassman for West Germany and Denmark, and it was suggested by this researcher that there were reasonable grounds for supposing that such a pattern had more general validity. The recent IMR figures for West Germany show 94% of German exports invoiced in Deutschmarks, the only minor exception being sales to USA. These figures are given in Appendix V.

Certainly, it seems that both in the UK and internationally there is a tendency for exporters to invoice in their own currencies.

## The Reasons for Currency Choice

In view of the differences between the prescriptive theory and available descriptive measurements, there appear grounds for examining what is known about the reasons for invoice currency choice by exporters. Since the advantages of foreign currency invoicing have been described earlier, the interest here lies primarily in the motivation for the choice of Sterling as invoice currency for the major part of export trade.

Firstly, there is the issue of the avoidance of uncertainty by the exporter, in the sense that with floating currencies, local currency invoicing produces variable Sterling income. Baron ( 80) has claimed that flexible exchange rates with forward cover lead to the same position as would exist with pegged rates, so that uncertainty can be avoided. However, as noted, this conflicts with evidence at the decision making level. Reid (442) uses case material to point out that industrialists are relatively slow to react to currency changes, while Barnes ( 49), Grassman (218) and Page (410) point to the decision maker's desire to conduct transactions in a familiar currency. Page (410) noted that her survey evidence suggested that exporters seemed to wish to avoid risk and uncertainty by using their own currency, more than they wish to make exchange rate gains by using foreign currencies. This attitude is reflected in the not uncommon notion that a trading company should avoid currency speculation:

> "we feel .... the company is in business to manufacture and sell at a profitable price, not to play the markets." ( 49)

secondly, closely associated with the uncertainty discussed above, is the risk associated with foreign exchange transactions. As noted in 3.2(d) above, Paulden (421) points out that the effect of the official stance against blanket forward selling of currency, is that many feel that effectively it is not worth covering orders of less than £25,000. This may act to remove the risk reducing mechanism from a substantial number of transactions, probably particularly those of the small and medium sized exporter.

This implies that in many cases the exporter is left as the bearer of foreign exchange risk, if invoices are in foreign currency. Lethbridge and Tylee (331) cite cases of medium sized firms where price lists and invoices are in Sterling because of the perceived risks of loss associated with floating exchange rates and fixed price lists in foreign currencies.

Baron ( 52) has pointed out that the risk-aversive exporter may choose to invoice in his own currency to avoid foreign currency exposure. Rodriguez (453) has gone further and classifies attitudes among companies to exchange risk as: risk paranoid, where any exposure is considered intolerable; neutral risk aversion, where financing and investment are conducted to maximise expected gains; and assymetrical risk aversion, where greater weight is attached by managers to a given expected exchange loss than to an expected exchange gain of the same magnitude. In the cases studied by Rodriguez, it appeared that while companies claimed that they never speculated, there was also support for the hypothesis that managers had assymetrical attitudes towards risk in the exchange market.

A third point in this review of the apparent reasons for actual exporter currency choices, which appears noteworthy, is the pressure towards the status quo, which may be derived in part from the notion of uncertainty and risk associated with change. Kahler and Kramer (282) have pointed out that market custom may be the prime determinant of currency choice in some circumstances. Similarly, in the UK, Wood and Carse (583) found that exporters tended to maintain their traditional currency arrangements, even under conditions of devaluation and floatation, preferring in these circumstances to maintain or increase Sterling prices. Indeed, some hostility to currency changes was reflected in Hague's study (227) and more recently in the Barclays Bank report:

> "Although many British companies benefitted from the price flexibility derived from the floating pound, surprisingly few spoke in favour of a downward float." (271)

A more concrete aspect of avoiding change is in seeking price stability. The Barclays Bank report (271) has pointed out that there are difficulties in selling, which are posed by constant price adjustments, in a similar way to that argued in the more general pricing context, in 2.1(b). Dunn (151) has argued that exporters use oligopoly power to maintain stable prices, through a form of variable price discrimination, since local prices are held stable in spite of movements in the local currencies against the exporter's. This may also be compared to the more general forces towards price stability assessed in the early part of this paper.

A fourth point in explaining currency choices, which is of some significance here, is that of the effect of the relative market strength between buyer and seller on the currency used for the transaction.

There tends to be an assumption that the choice of currency lies in the hands of the exporter. Muir (372) and Page (410) point out that commonly both exporter and importer would prefer their own currencies to be used, but it is argued, for example by Grassman (217), that in determining the terms of contract the currency choice is the seller's initiative.

This, however, does not resolve the question of why both weak and strong currency exporters invoice in their own currencies, when this may be a disadvantage for the weak currency exporter and an advantage for the strong currency exporter.

It is possible that part of the answer may lie in the relative strength of market power between the exporter and importer.

For example, Gehrmann et al (202) point out that German exporters prefer to deal in Deutschmarks and use a strong market position to enforce this (and an emphasis on non-price competition).

Conversely, it may be that a lack of market power (and perhaps a reliance on price competition) may oblige those UK exporters who would have preferred to invoice in local currencies to use Sterling.

Paulding (421) reports that some countries tend to insist that British suppliers should invoice in Sterling, citing Japan as the outstanding example.

Similarly, a recent Midland Bank report argues that often the exporter's ability to persuade a customer to contract in foreign currency is limited:

> "in the majority of cases the exporter is selling in a buyer's market, against strong foreign competition for the order, and hence is often in no position to dictate the currency of contract." (360)

On such grounds, Rosendale (457) has pointed to the interaction between an exporter's market strength and his ability to manipulate the price and currency variables.

Page (410) has shown that there appears to be a pattern that exporters in countries which have a high share of world trade tend to invoice in their own currencies, citing France and the UK with approximately 70% of exports invoiced in their own currencies, and the corresponding figure of approximately 80% for West Germany and USA. This evidence, however, leaves unsolved the problem highlighted above: that own currency invoicing is attractive in economic and financial terms to hard-currency countries, but less so for soft-currency countries and their respective exporting firms.

This last point is shared by Wood and Carse (583) who point to the banking assumption that the currency of invoicing is determined by the buyer, which implies that importers in the UK and other countries are choosing to be invoiced in exporters' currencies.

Recalling earlier commentary on the export strategy open to the exporter, one aspect of market strength, particularly in the case of the smaller firm, is the degree of dependence on local distributors or agents. There have been some suggestions that the benefits of floatation may be taken by the distributor rather than the exporter or end-user, for example in (383). It may be that the strong distributor (where strength is taken in terms of market knowledge, buyer contacts or other expertise or economic advantage) will be in a position to insist on, or greatly favour, being invoiced in Sterling, while normally pricing to users in his local currency.

Some confirmation of this distributive power was reflected in the recent Barclays Bank study:

> "where companies maintained their Sterling prices, hoping to see a reduction in the price of their products abroad, their hopes seldom materialised. On visits to department stores

> in Frankfurt or Paris after Sterling had declined by some 20 per cent, one saw no change in the prices of British goods and the purchasing managers had ready excuses for keeping prices unchanged." (271)

There appear some grounds, therefore, for relating the choice of Sterling as invoice currency by UK exporters to their lack of market power to enforce local currency invoicing, particularly where overseas distributors or customers anticipate an advantage to themselves from Sterling invoicing.

A fifth issue in attempting to explain the residual importance of Sterling as export invoice currency, which is closely related to the above market strength argument, is concerned with the type of market strength being pursued.

If it is accepted that the invoice currency used is one aspect of the price offer, then there are grounds for returning to the earlier distinction (see 3.1(d) above) between price and non-price competitive strategies.

For example, at a time when the Deutschmark was stronger than most other currencies, Gerhmann (202) argued that German exporters were able to enforce their preference for Deutschmark invoicing by virtue of market strength in general, but particularly the strength associated with superior product quality and high delivery reliability, as components of non-price competition.

The Barclays Bank report comments:

> "companies and countries who have to work under the shadow of falling exchange rates can become obsessed with minute price differentials and tend to lose their sense of proportion .... others believed that frequent downward floats can create a 'bargain basement' mentality, that 'success comes from price-cutting'," (271)

In a similar way, Grassman (218) has pointed out that currency choice may be determined by the availability of credit and other services, for example forward cover, which may vary substantially between currencies.

The final points which may offer some explanatory power are those discussed earlier, regarding the strategic choice of numbers of export markets and the export objectives being pursued (see 3.1(a) and 3.1(b) above).

The BETRO ( 62) argument is that concentration on key markets makes it more realistic to invoice each in its own currency, so conversely, those companies pursuing a market spreading approach may not be in a position to administer local currency invoicing, at least not in all markets. This is particularly significant given the evidence suggesting that concentration strategies are far from universally accepted by exporters.

Similarly, the company's stage or type of internationalisation, perhaps indicated by the proportion of business exported, may offer some indication of export or local currency patterns. For example, the firm exporting a small proportion of turnover may not consider the gains large enough to change to local currency invoicing.

It would seem then that possible explanation for the choice of Sterling as invoice currency for a large proportion on UK exports may include: the avoidance of uncertainty and overt exchange rate risk; the acceptance of prevailing practice, custom or tradition, the inability to enforce local currency invoicing, through the lack of market power in a buyer's market; the reliance on price competition; and the difficulties in managing multi-currency invoicing with market spreading strategies or in the early, passive, reactive stages of internationalisation within the firm.

This leads to the formulation of research objectives 5 and 6 and the hypotheses associated with these.

## Research Objectives and the Hypotheses to be Tested

### Objective 5: Export Invoice Currency Strategy

The fifth objective of the primary research is to assess the determinants of export invoice currency choice and its effect on export price levels.

There are some indications that while the bulk of UK exports are invoiced in Sterling, there are variations in invoicing practice between industries (see, for example, 543, 544, 545, 546, 547). It is therefore necessary to measure the invoice currency patterns in the industries studied, leading to hypothesis (a).

In view of the large amount of published normative work favouring foreign currency invoicing, there appears to be a need to establish if Sterling invoicing represents a deliberate managerial choice - hypothesis (b).

Noting the relatively small overall increases in the practice of local currency invoicing, and since floatation differs in some of its effects from devaluation, it is possible that exporters may choose to ride out weak Sterling periods and gain in strong Sterling periods (at least in some ways), by simply avoiding the change from Sterling to foreign currency - hypothesis (c).

From the analysis above of the possible explanations for the use of Sterling as the major export currency, it appears that the decision may be influenced by such factors as the uncertainty of currency movements, pressure from competitors, pressure from distributors and the exporter's own administrative ease - hypotheses (d), (e), (f) and (g).

Further, it is suggested that there is a relationship between the firm's type or stage of internationalisation and the choice of Sterling as export currency, and the export strategy adopted, the availability of marketing information and the emphasis on price competition - hypotheses (h), (i), (j) and (k).

Finally, there is the issue of the interaction between actual prices paid by importers and the invoice currency strategy. It is proposed here that when Sterling floats down, the tendency is for the benefit to be taken by exporters in improved profitability, while when Sterling floats up, the impact is felt on prices - hypotheses (l), (m), (n) and (o).

Hypotheses

5(a) That the main currency of invoicing exports is Sterling.

5(b) That the choice of Sterling as invoice currency is deliberate and conscious, rather than reflecting a lack of awareness of the options faced.

5(c) That invoice currency is regarded as long-term and strategic, rather than a short-term tactical weapon.

5(d) That UK exporters choose to invoice in Sterling because of the uncertainty involved in currency movements in floatation.

5(e) That customer pressure acts against the adoption by the UK exporters of local currency invoicing.

5(f) That overseas distributor pressure acts against the adoption by UK exporters of local currency invoicing.

5(g) That UK exporters choose to invoice in Sterling for their own administrative ease.

5(h) That reactive exporters invoice in Sterling more than do active exporters.

5(i) That exporters pursuing market spreading invoice in Sterling more than do those pursuing market concentration.

5(j) That exporters with less marketing information invoice in Sterling more than do those with more marketing information.

5(k) That exporters emphasising price competition invoice in Sterling more than do those emphasising non-price competition.

5(l) That exporters invoicing in Sterling do not allow importer prices to fall when the pound floats down.

5(m) That exporters invoicing in Sterling do allow importer prices to increase when the pound floats up.

5(n) That exporters invoicing in local currencies maintain importer prices when the pound floats down.

5(o) That exporters invoicing in local currencies reduce importer prices when the pound floats up.

Objective 6: Invoice Currency and Market Strength

The sixth objective is to analyse the relationship between local market currency strength and exporter discretion in invoice currency choice, particularly in terms of the exporter's ability to exploit currency floatation.

From the discussion in this part of the paper of the reasons identified as having some explanatory power, one which appears of particular interest is the impact of relative market and bargaining strength between the exporter and local buyer, whether this is the distributor or end-user of the product.

It has been seen that strong currency exporters (for example, those in West Germany and Sweden) and weak currency exporters (for example, those in the UK until recent months) appear to choose to invoice exports in the exporter's own currency.

Broadly, this may be seen to be to the economic advantage of the former and disadvantage of the latter. One possible explanation for the paradox apparently contained within this may be that local buyers are able to insist on invoices in the weaker currency when dealing with UK suppliers, but tend to accept invoicing in the harder currency when dealing with suppliers from countries like West Germany, in just the same way that they appear willing to pay higher prices to some. This may be simply an aspect of the differences between competing on price as opposed to non-price grounds, in the way discussed earlier.

Further, if this line of reasoning is pursued, then it is possible that it is importers whose own currency is stronger than Sterling, who are most likely to insist on UK suppliers invoicing in Sterling, and importers whose currency is weaker than Sterling who are most likely to favour local currency invoicing by exporters.

Hypotheses

6(a) That where local currency invoicing is attractive for UK exporters, market power acts against its implementation, and where local currency invoicing is relatively unattractive for the UK exporter, then market power leads to its implementation.

6(b) That markets with relatively weak currency offer the UK exporter the opportunity to invoice in local currency.

6(c) That markets with relatively strong local currency offer little opportunity for the UK exporter to invoice in local currency.

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