Guidelines

Export Price Calculation and Preparation of Quotations

The folowing considerations will help you determine the best price for the product overseas.

- At what price should the firm sell its product in the foreign market?
- What type of market positioning (customer perception) does the company want to convey from its pricing structure?
- Does the export price reflect the product's quality?
- Is the price competitive?
- Should the firm pursue market penetration or market-skimming pricing objectives abroad?
- What type of discount (trade, cash, quantity) and allowances (advertising, trade-off) should the firm offer its foreign customers?
- Should prices differ by market segment?
- What should the firm do about product line pricing?
- What pricing options are available if the firm's costs increase or decrease? Is the demand in the foreign market elastic or inelastic?
- Are the prices going to be viewed by the foreign government as reasonable or exploitative?
- Do the foreign country's antidumping laws pose a problem?

As in the domestic market, the price at which a product or service is sold directly determines a firm's revenues. It is essential that a firm's market research include an evaluation of all of the variables that may affect the price range for the product or service. If a firm's price is too high, the product or service will not sell. If the price is too low, export activities may not be sufficiently profitable or may actually create a net loss.

The traditional components of determining proper pricing are costs, market demand, and competition. Each of these must be compared with the firm's objective in entering the foreign market. An analysis of each component from an export perspective may result in export prices that are different from domestic prices.

It is also very important that the exporter take into account additional costs that are typically borne by the importer. They include tariffs, customs fees, currency fluctuation transaction costs and value-added taxes (VATs). These additional costs can add substantially to the final price paid by the importer, sometimes resulting in a total of more than double the U.S. domestic price.

Foreign Market Objectives

An important aspect of a company's pricing analysis is determining market objectives. For example, is the company attempting to penetrate a new market, looking for long-term market growth, or looking for an outlet for surplus production or outmoded products? Many firms view the foreign market as a secondary market and consequently have lower expectations regarding market share and sales volume. This naturally affects pricing decisions.

Marketing and pricing objectives may be general or tailored to particular foreign markets. For example, marketing objectives for sales to a developing nation where per capita income may be one tenth of that in the United States are necessarily different from the objectives for Europe or Japan.

Costs

The computation of the actual cost of producing a product and bringing it to market is the core element in determining if exporting is financially viable. Many new exporters calculate their export price by the cost-plus method. In the cost-plus method of calculation, the exporter starts with the domestic manufacturing cost and adds administration, research and development, overhead, freight forwarding, distributor margins, customs charges, and profit.

The effect of this pricing approach may be that the export price escalates into an uncompetitive range. ***Table 4*** gives a sample calculation. It clearly shows that if an export product has the same ex-factory price as the domestic product, its final consumer price is considerably higher once exporting costs are included.

Marginal cost pricing is a more competitive method of pricing a product for market entry. This method considers the direct, out-of-pocket expenses of producing and selling products for export as a floor beneath which prices cannot be set without incurring a loss. For example, additional costs may occur due to product modification for the export market that accommodates different sizes, electrical systems, or labels. On the other hand, costs may decrease if the export products are stripped-down versions or made without increasing the fixed costs of domestic production.

Other costs should be assessed for domestic and export products according to how much benefit each product receives from such expenditures. Additional costs often associated with export sales include:

- Market research and credit checks;
- Business travel;
- International postage, cable, and telephone rates;
- Translation costs;
- Commissions, training charges, and other costs involving foreign representatives;
- Consultants and freight forwarders; and
- Product modification and special packaging.

After the actual cost of the export product has been calculated, the exporter should formulate an approximate consumer price for the foreign market.

Table 4
Sample Cost-Plus Calculation of Product Cost

	Domestic Sale	Export Sale
Factory price	Euro7.50	Euro7.50
Domestic freight	.70	.70
subtotal	8.20	8.20
Export documentation		.50
subtotal		8.70
Ocean freight and insurance		1.20
subtotal		9.90
Import duty (12 percent of landed cost)		1.19
subtotal		11.09

Wholesaler markup (15 percent)	1.23	
subtotal	9.43	
Importer/distributor markup		2.44
subtotal		13.53
Retail markup (50 percent)	4.72	6.77
Final consumer price	Euro14.15	Euro20.30

Market Demand

For most consumer goods, per capita income is a good gauge of a market's ability to pay. Some products may create such a strong demand such as popular goods like Levis, that even low per capita income will not affect their selling price. Simplifying the product to reduce its selling price may be an answer for the exporter to most lower per capita income markets. The firm must also keep in mind that currency fluctuations may alter the affordability of its goods. Thus, pricing should try to accommodate wild changes in the U.S. and/or foreign currency. The firm should anticipate the type of potential customers. If the firm's primary customers in a developing country are expatriates or belong to the upper class, a higher price might be feasible even if the average per capita income is low.

Competition

In the domestic market, few companies are free to set prices without carefully evaluating their competitors' pricing policies. This situation is true in exporting, and is further complicated by the need to evaluate the competition's prices in each potential export market.

If there are many competitors within the foreign market, the exporter may have little choice but to match the market price or even underprice the product or service in order to establish a market share. On the other hand, if the product or service is new to a particular foreign market, it may actually be possible to set a higher price than in the domestic market.

Pricing Summary

In summary, here are the key points to remember when determining your product's price:

- Determine the objective in the foreign market.
- Compute the actual cost of the export product.
- Compute the final consumer price.
- Evaluate market demand and competition.
- Consider modifying the product to reduce the export price.
- Include "nonmarket" costs, such as tariffs and customs fees.
- Exclude cost elements that provide no benefit to the export function, such as domestic advertising.

Quotations and Pro Forma Invoices

Many export transactions, particularly initial export transactions, begin with the receipt of an inquiry from abroad that is followed by a request for a quotation. The preferred method for export is a pro forma invoice, which is a quotation prepared in invoice format.

A quotation describes the product, states a price for it, sets the time of shipment, and specifies the terms of the sale and terms of the payment. Since the foreign buyer may not be familiar with the product, the description of it in an overseas quotation usually must be more detailed than in a domestic quotation. The description should include the following 15 points:

1. Seller's and buyer's names and addresses.
2. Buyer's reference number and date of inquiry.
3. Listing of requested products and brief description.
4. Price of each item (it is advisable to indicate whether items are new or used and to quote in U.S. dollars to reduce foreign-exchange risk).
5. Appropriate gross and net shipping weight (in metric units where appropriate).
6. Appropriate total cubic volume and dimensions packed for export(in metric units where appropriate).
7. Trade discount (if applicable).
8. Delivery point.
9. Terms of sale.
10. Terms of payment.
11. Insurance and shipping costs.
12. Validity period for quotation.
13. Total charges to be paid by customer.
14. Estimated shipping date from U.S. port or airport.
15. Currency of sale.

Pro forma invoices (see sample) are not used for payment purposes. In addition to the 15 items previously mentioned, a pro forma invoice should include two statements. One that certifies the pro forma invoice is true and correct and another that gives the country of origin of the goods. The invoice should also be clearly marked "pro forma invoice."

Pro forma invoices are models that the buyer uses when applying for an import license, opening a letter of credit or arranging for funds. In fact, it is a good practice to include a pro forma invoice with any international quotation, regardless of whether it has been requested or not. When final commercial invoices are being prepared prior to shipment, it is advisable to check with the U.S. Department of Commerce or another reliable source for any special invoicing requirements that may be required by the importing country.

If a specific price is agreed upon or guaranteed by the exporter, the precise period during which the offer remains valid should be specified. Additionally, it is very important that price quotations state explicitly that they are subject to change without notice.

Terms of Sale

In any sales agreement, it is important that there is a common understanding of the delivery terms since confusion over their meaning can result in a lost sale or a loss on a sale. The terms in international business transactions often sound similar to those used in domestic business, but they frequently have very different meanings. For this reason, the exporter must know the terms before preparing a quotation or a pro forma invoice.

A complete list of important terms (including many new terms and abbreviations)and their definitions is provided in *Incoterms 1990*. This booklet is issued by ICC Publishing Corporation, Inc., 156 Fifth Avenue, Suite 820, New York, NY 10010; telephone 212-206-1150.

The following are a few of the more frequently used terms in international trade:

- **CIF (cost, insurance, freight)** to a named overseas port where the seller quotes a price for the goods (including insurance), all transportation, and miscellaneous charges to the point of debarkation from the vessel. (Used only for ocean shipments.)
- **CFR (cost and freight)** to a named overseas port where the seller quotes a price for the goods that includes the cost of transportation to the named point of debarkation. The the buyer covers the cost of insurance. (Used only for ocean shipments.)
- **CPT (carriage paid to)** and **CIP (carriage and insurance paid to)** a named place of destination. These terms are used in place of CFR and CIF, respectively, for all modes of transportation, including intermodal.
- **EXW (ex works)** at a named point of origin (e.g., ex factory, ex mill, ex warehouse)where the price quoted applies only at the point of origin. The seller agrees to place the goods at the buyer's disposal at the specified place within the fixed time period. All other charges are put on the buyer's account.
- **FAS (free alongside ship)** at a named port of export where the seller quotes a price for the goods that includes the charge for delivery of the goods alongside a vessel at the port. The seller handles the cost of wharfage, while the buyer is accountable for the costs of loading, ocean transportation, and insurance.
- **FCA (free carrier)** at a named place. This term replaces the former "FOB named inland port" to designate the seller's responsibility for handing over the goods to a named carrier at the named shipping point. It may also be used for multimodal transport, container stations, or any mode of transport, including air.
- **FOB (free on board)** at a named port of export where the seller quotes the buyer a price that covers all costs up to and including the loading of goods aboard a vessel.
- **Charter Terms:**

- **Free In** is a pricing term that indicates that the charterer of a vessel is responsible for the cost of loading goods onto the vessel.
- **Free In and Out** is a pricing term that indicates that the charterer of the vessel is responsible for the cost of loading and unloading goods from the vessel.
- **Free Out** is a pricing term that indicates that the quoted prices include the cost of unloading goods from the vessel.

It is important to understand and use sales terms correctly. A simple misunderstanding may prevent exporters from meeting contractual obligations or make them responsible for shipping costs they sought to avoid.

When quoting a price, the exporter should make it meaningful to the prospective buyer. For example, a price for industrial machinery quoted "EXW Saginaw, Michigan, not export packed" is meaningless to most prospective foreign buyers. These buyers would find it difficult to determine the total cost and might hesitate to place an order.

The exporter should quote CIF or CIP whenever possible, as it shows the foreign buyer the cost of getting the product to or near the desired country.

If assistance is needed in figuring CIF or CIP prices, an international freight forwarder can help. The exporter should furnish the freight forwarder with a description of the product to be exported and its weight and cubic measurement when packed. The freight forwarder can compute the CIF price usually at no charge.

If at all possible, the exporter should quote the price in U.S. dollars. This will eliminate the risk of exchange rate fluctuations and problems with currency conversion.