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A PRICING PLAYBOOK FOR EMERGING MARKETS

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Pricing in emerging markets—always tricky to manage because of fluctuating inflation rates, shifting interest costs, and volatile currencies—is becoming even harder for multinational corporations (MNCs) to master. These companies face rising competition, from other MNCs in premium niches and from local giants in middle-market segments, that is squeezing MNCs' profit margins in many emerging markets. In addition, traditionally value conscious consumers have become even more price sensitive in these times of slower growth and higher inflation.

Compounding the problem is a lack of reliable consumer data and competitive information. Pricing is often an afterthought, even among MNCs, in emerging markets. Moreover, the time-tested pricing methods that companies use in their home markets simply don't work abroad. Executives discover, to their surprise, that consumers in emerging markets view products and services—and their value—differently from consumers in developed markets. What's more, spending power, willingness to pay, consumer segments, and the marketing, distribution, and selling of products and services also differ in emerging markets.

All those factors demand a fundamentally new pricing playbook—one that addresses not just price levels but also pricing structures, promotions, and the terms by which products must be sold to distributors and retailers. As emerging markets evolve at a dizzying pace, smart companies maintain their pricing effectiveness by deploying six dynamic strategies.

Understand Local Perceptions

Although it's tough for many MNCs to accept, consumers in emerging markets perceive the advantages and disadvantages of products and services—both consumer and business—in idiosyncratic ways. Those views are the byproduct of several factors—including income levels, consumption patterns, tastes, religious preferences, climate, and fashion trends—and they usually contrast radically with the views of consumers in the developed world.

Smart MNCs figure out the innate local appeal of their products and services in each emerging market and then formulate pricing strategies around them that maximize profits. This allows the companies both to command prices that are higher than those of local rivals and to expand into new niches, especially since the appeal of MNCs' brands is usually distinct from that of local brands.

Consider, for instance, a European leader in the elevators market that usually sells its products to builders of office complexes. When the company began to target customers in emerging economies, it discovered that residential developers were more eager than commercial developers to buy its elevators, primarily because the products were more dependable than those made by local manufacturers. Reliability is a key purchase criterion in emerging markets because fewer elevator banks are installed in apartment buildings there than in similar buildings in the developed world.

Complications arose, though, when the company switched its sights from the commercial segment in emerging markets to the residential and priced its products at a premium. While builders and contractors appreciated the greater dependability of the products, they weren't willing to pay much more for it. And they were reluctant to accept that lower maintenance costs and higher levels of customer satisfaction would outweigh the increased upfront investments.

To counter those concerns, the European company started educating builders about how and why it is appropriate to pay more for better quality. The company also tried to shift the odds in its favor by working with key players in the decision-making process. For instance, it launched a communications campaign to persuade apartment buyers and real estate management companies to get builders to install its elevators. Over time, that effort helped the European company crack open the residential segment in several emerging economies.

Capitalize on Cachet

Most global brands enjoy a higher status in emerging markets than they do in developed markets, particularly when they are first launched. This is partly because of scarcity; many emerging markets had been closed to outside competitors for decades, so when MNCs were finally allowed to enter, they found an enormous pent-up demand for their brands. The larger-than-life image that foreign companies enjoy enables them to charge higher prices for many years after entering an emerging market, until either demand plateaus or supply substantially expands.

The phenomenon becomes more pronounced when a company hails from a part of the world that has garnered a reputation for making a specific product. Consumers traditionally believe that certain nations' products are the best: Belgian chocolates, French wines, German machine tools, Italian leather, Swiss watches, and so on. Smart companies identify the country-of-origin effects that apply to their offerings and factor them into their pricing. One classic example is Levi Strauss & Co., which developed denim jeans in 1873. The products' All-American authenticity continues to resonate strongly in several emerging markets, allowing the company to charge a premium.

Create Price Ladders with Very Low Bottom Rungs

It's easy to believe that a single price for a single product works best in crowded emerging markets. A single price allows companies to maximize profit margins, protect the brand, attract the right consumers, and stand out from the pack. Moreover, MNCs worry about confusing consumers with several prices, particularly given that segmenting the market is challenging because of the lack of adequate data on incomes and purchasing power. (See the sidebar, "Debunking Pricing Myths in Emerging Markets.")

However, MNCs that adopt a single-price model don't make the most of their pricing power. One price, however carefully cho-

DEBUNKING PRICING MYTHS IN EMERGING MARKETS

As emerging markets become more mature, mistaken beliefs about pricing seem only to gain ground. Here are five myths that multinationals should tackle.

Myth 1: Prices are much lower in emerging markets than in developed markets.

While it's true that consumers in emerging markets are, on average, less affluent than their counterparts in the developed world, income levels do vary and include both a growing middle class and a relatively wealthy bracket. Incomes and aspirations are also rising across the board, which has spurred greater spending. Companies can—in fact, they must—carefully segment the market when drawing up their pricing strategies.

Myth 2: Premium pricing doesn't work because people just won't pay for additional features and services.

In several segments, and not just at the top of the market, consumers are more than willing to pay global prices. That's partly because consumers in emerging markets place a higher value on new features and state-of-the-art technology than do their counterparts in developed markets. Because those consumers seek out brands for both the cachet and the guarantee of quality that they provide, it's sometimes easier to build premium brands in emerging markets.

Myth 3: Traditional retailers don't worry about pricing.

Traditional retailers are often closer to consumers—and have sharper insights into consumer behavior, including price-related trends—than modern retailers. They can gauge shoppers' reactions quickly and adjust the product mix and prices on the fly. Many emerging-market consumers, even in cities, browse modern stores for ideas and fun but prefer to make purchases in traditional shops, where service is usually better.

Myth 4: Promotional pricing in emerging markets only ends up hurting companies' brands and images.

Consumers in emerging markets love bargains—and bargaining—and are avid shoppers, too. Consequently, promotions and discounts, especially on new offerings, work well in the short run. However, as in developed markets, companies can't rely solely on discounts; they must figure out the right mix of regular and promotional pricing to maintain their long-term brand images.

Myth 5: Consumers in emerging markets make decisions based only on (low) prices, not features or quality.

Consumers at all income levels in emerging markets consider factors other than price when making purchase decisions. Key among those factors: quality, locally relevant features and services, product and service performance, and brand image. Consumers usually compare several options and are willing to pay hefty premiums for features that matter to them. Many consumers even factor in travel costs to the purchase equation, so convenient retail locations and competitive prices are important for success.

sen, will inevitably result in missed opportunities: some buyers would have paid more, while potential buyers would have made a purchase if only the price had been lower. The best way to tackle this issue, particularly in economies with large income disparities, is to offer an array of products at numerous price points.

Unlike in the developed world, where price ladders usually have three rungs, smart companies in emerging economies create price ladders with four: basic, good, better, and best. In this model, the bottom rung is very low, while the top rung is aspirational, thus enhancing perceptions about the product.

Companies benefit both by reaping higher margins from some customers and by serving those who would never have bought had lower-priced options not been available—critical for continued growth in emerging markets. For example, when a global manufacturer began to sell its consumer food products in Brazil, it launched an inexpensive new product in snack-size packs under a lesser-known brand name to woo entry level consumers in suburban and rural markets. At the same time, it expanded the distribution of its more familiar brands to other parts of the country in larger sizes and at higher price points. The moves helped the company make inroads into both markets.

Another benefit of creating a four-tier price ladder is that customers gradually become more comfortable with the idea of paying higher prices for more features and new technologies. The European elevator giant we mentioned earlier, for instance, initially launched only one product in emerging markets but later decided to sell several products, offering advanced features at higher prices. When buyers realized that they would give up features to get a lower price, many passed up the lowest-priced products in favor of the relatively more expensive intermediate versions. Thus, the multitiered pricing structure enabled the company to generate higher revenues than those it would have realized if it had clung to a single price point.

Charge More for Less

Many MNCs start out in emerging markets by targeting the top of the pyramid, which accounts for around 1% of the population and 20% of consumption. Later, they try to break into the middle of the market, which is much bigger, accounting for 30% to 50% of the inhabitants and around 50% of consumption. However, the income levels of the middle class in emerging markets are lower than they are in the West, so the per-capita consumption of almost everything is quite low by developed-economy standards.

Companies and consumers in emerging economies are usually willing to buy only small quantities at a time. Companies typically do so to avoid tying up scarce cash in inventory, while consumers often do so to remain within meager budgets. Smart companies deal with that by changing the sizes of the containers in which products are packaged, which affects pricing. For example, an American food company doing business in Mexico found that rural consumers who bought its products sought to make only tiny purchases, usually equivalent to well under a dollar. The company realized that offering smaller packages was essential to ensure that local consumers would buy more.

Lower prices for smaller packages needn't result in smaller profits, however; MNCs can afford to optimize pricing to make as much, if not more, profit than they do with larger packages. A US-based leader in the cooking-oil business, for instance, determined that it would have to offer products in small containers if it wanted to attract consumers in India. Although its packaging costs rose, the company started charging more per liter when it sold the product in smaller containers. That enabled it to both earn higher profits and hold on to its upmarket positioning. Interestingly, the company was initially befuddled by the fact that its sales kept rising in rural areas, so it sent out representatives to discover why. The visits revealed that shopkeepers were buying large containers, opening them, and reselling the product by the spoonful or cupful. Clearly, it isn't enough to just study data in emerging markets.

Tailor Pricing to the Channel

Distribution and retail channels in emerging markets can be classified as either traditional or modern, and the two categories influence pricing strategies differently. In emerging markets, modern retail channels feature newer formats and service outlets—such as supermarkets, hypermarkets, fast-food chains, beauty parlors, and fitness centers—that offer wider assortments, better ambience, and higher quality brands. Because these channels depend heavily on promotions and prices to attract customers, they offer the lowest prices, develop sophisticated incentive systems for in-store promotions and positioning, and thrive on cosponsored advertising.

Traditional retail channels, by contrast, are smaller in terms of area, the size of the workforce, and the number of SKUs in which they invest. Managing cash is critical for such channels, so they expect MNCs to offer financial incentives in the form of liberal payment terms and unlimited returns. What's more, these mom-and-pop stores maintain low inventories that require frequent replenishment, and they depend on quick turnover for survival. Choosing the optimal product mix, therefore, is very important.

Companies must often make direct investments in traditional retail. For instance, some MNCs supply stores with branded coolers to ensure beer distribution, while others create promotional packs that can be attached to shelves with clips, thereby increasing shelf space.

Wholesalers possess enormous influence in emerging markets, so companies must oversee them closely. They have to collect the sell-in and sell-out prices of products, calculate margins, and monitor the sell-out prices to ensure that goals are aligned. If a manufacturer's aim is greater market penetration, but its distributor wants to maximize profits, for example, the two must work together to figure out a price that will suit both.

Manufacturers must also educate distributors about the most effective pricing models. Consider, for instance, an American textbook publisher that launched its products in an Asian country where two distributors dominated the market. Realizing that the distributors' prices were increasing neither sales nor sampling, the American company crunched the numbers to figure out for which grade levels and topics demand was the most price sensitive. It then incorporated tear-off discount coupons into the packaging of the textbooks for those segments, effectively reducing prices. That helped boost sales without jeopardizing the company's relationships with the powerful distributors.

Companies in emerging markets must also develop innovative solutions for other problems, such as arbitrage, in which products are bought in low-price markets and sold in high-price markets. One transnational cement manufacturer found that offering rebates can prevent arbitrage. The company provides a barcode for every one of its dealers' trucks, and that barcode must be scanned at unmanned checkpoints located between the factories and the markets. Two pictures are taken at these checkpoints, including one of the truck's top, to verify that all the cement bags are still in the truck and are on track to arrive at the intended market. The information is then transmitted wirelessly to a central server, and, at the end of every month, the company's dealers are awarded monetary rebates based on the data collected at the checkpoints. This process has virtually eliminated arbitrage and has led to an additional 1% return on the company's sales.

Change Pricing by Stage

MNCs in emerging markets tend to underestimate local companies, which often use homegrown brands and well-established channel relationships to dominate the market. Because the local businesses don't have to worry about global policies, repercussions, or clearances from headquarters, they can raise or lower prices quickly, expand rapidly into new product and geographic markets, and exert whatever influence they might have with local governments, if necessary, to enact favorable rules and regulations.

MNCs, therefore, have no choice but to follow a staged pricing strategy. There are usually three stages: introductory, growth, and maturity. Companies design introductory pricing to highlight the benefits of new products and services and to reduce uncertainty around trials even as they try to retain the freedom to increase prices later. This involves time-sensitive trial pricing, product and service guarantees, and, of course, discounting. Rarely does it mean slashing published prices.

Flat pricing is an effective introductory pricing structure in markets where a structure of fixed fees plus variable charges predominates. In Indonesia, for example, when a startup owned by a Chinese telecommunications conglomerate offered voice, text, and data for a flat fee every month, it notched up double-digit subscriber growth for a long time. That's because the market leaders' elaborate pricing plans, designed to generate the maximum revenues per customer, had become complicated and confusing.

When MNCs enter the growth phase, those that started out with high prices will typically continue selling at high prices to maximize profits, while those trying to build market share will reduce prices. If sales continue to increase but begin to slow down, the product may have entered maturity. Profits will be higher than they used to be, but competition will make it difficult to acquire new users. Protecting market share becomes the priority during the maturity stage, so discounting becomes essential.

It's important to remember that, historically, emerging markets have changed more rapidly than developed markets have. Their growth may never become linear, but the path forward can be determined by using techniques such as war gaming. During a war game, internal teams, reinforced by outside experts, simulate buying and selling. The results are often counterintuitive.

For example, a provider of offshore support vessels recently bid on a South American oil field development project as a member of a global consortium. Before submitting its bid, the company conducted a war game. The results suggested that, as a result of various factors, the oil field might become less profitable over time. The company smartly decided to front-load its pricing so that its contracts would become part of the capital budget for the project's construction rather than part of the budget for maintenance, which might eventually become subject to cost-cutting and negotiation. Doing so enabled the corporation to maximize profits right away.

PRICING MAY NOT be the glitziest element in the marketing mix, but when carefully considered and applied, it often proves to be the most powerful. Few MNCs, therefore, are likely to win in emerging markets unless they learn how to come up with innovative pricing strategies and deploy them more effectively.

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