Crossroads

A thought provoking publication series from Management3

M3 MANAGEMENT THREE

International Pricing Strategy in B2B Markets

As the automotive aftermarket developed, diverse market structures and business practices led to disparities in replacement parts prices between European countries. The EU Internal Market has facilitated increased integration, but differences still remain. Many companies face margin risks because they sell products to their first line customers at different prices in different countries, although there may also be upside opportunities. International Aftermarket Pricing Strategies need to take product and market related challenges into account to minimize risk, maximize competitiveness and optimize gross margin. The first step is to assess the actual level of risk, before deciding how best to respond given the company's own culture, processes and systems. Component manufacturers which take action to manage cross-border pricing in Europe will not only be well placed to achieve medium to long term goals without sacrificing short term performance.

Historically component manufacturers operated in Europe with semi-autonomous subsidiaries or importers in every national market. Each of these set prices for the company's products on the basis of local conditions and market specific discount structures. This meant that a first line customer in one country might be paying much less for a specific item than a counterpart in a neighbouring country.

This didn't matter much when there were borders between national markets and few customers were aware of price differentials. But barriers to cross-border trade fell with the creation of the European single market in 1992 and the introduction of the Euro ten years later made it straightforward for customers to compare prices for the same item in different countries.

Although markets have become more integrated over the last 15 years the European Aftermarket is still far from homogeneous. Significant differences remain because diverse national vehicle parcs and distribution structures mean that market requirements differ by country. Component manufacturer price setting needs to take these factors into account, which naturally leads to cross border price differentials.

To illustrate, M3 checked the recommended retail price of a fast moving brake pad from a global original equipment supplier in Germany (€60,30 +VAT) and Italy (€75,00 + VAT) - a difference of 25%. Emerging internet parts retailers make these differences more readily visible to consumers, as Mister-auto's prices for a Bosch brake pad show:

0 986 484 019	France	Germany
Net Price (incl VAT)	€15.53	€35,70

Prices collected from Mister–auto websites 03/2013

Given the relative ease of price comparison across borders and the emergence of international customers, the risks created by price differentials are growing, and they need to be identified and quantified as the basis for a strategic pricing response.

The first step is to answer three key questions:

1. How big are national price differences?
Comparing prices in neighboring markets shows how much risk there is if they fall to the lowest level.

2. What are competitors doing?
Analyzing the competition's recommended retail prices will show how far they have harmonized pricing between different national markets, if at all. Competitor action or inaction may prompt customers to pressurize all suppliers for price harmonization: understanding the situation helps take control of the process and may reveal opportunities for companies to take the lead where there are benefits for their own business.

3. Are customers rational buyers?
Pride, rivalry and suspicion mean that most customers are unlikely to open up to each other and compare their purchase prices directly. But consolidation in a supplier's customer base is a threat. A customer with operations in more than one country can readily identify national differences in purchasing costs for the same product. If that customer acts as a rational buyer it will seek to purchase products for all markets at the lowest price found in any one market.

If answering these three questions shows there is risk the next step is to decide how to manage it.

Identifying the risk is not enough on its own. The Aftermarket faces both product related and market related challenges which should be considered in planning a European pricing strategy:

Product Challenges

- Improved product quality increasing replacement intervals and reducing volumes
- Vehicle Manufacturer initiatives to develop aftermarket product ranges and compete aggressively on price with the independent Aftermarket
- Proliferation of vehicle models and versions reducing parts sales per application, meaning fewer fast moving and more medium or slow moving items
- Emerging Asian competitors which are also suppliers

Market Challenges

- New players in distribution, especially from eastern Europe
- Emergence of internet parts retailers
- Evolving traditional distributors, with an increase in international operators
- Blurring of the barrier between OES and independent aftermarket
- Low cost alternatives gaining share at the bottom of the pyramid

Pricing strategies which do not take all of these factors into account risk creating more problems than they solve. On top of that, they need to be based on an individual company's capability, culture, systems and processes.

While decentralized organizations and pricing responsibilities were appropriate in the aftermarket of 20 years ago, they may not be appropriate in today's more integrated circumstances. Product pricing is central to delivering gross margin and profitability and the approach to a more integrated market may range from "light touch" international coordination with specific product pricing responsibility retained in each country, to complete centralization with no local decision making responsibility.

Addressing European pricing touches on sensitive issues and questions which directly affect business performance, so it requires buy-in from the whole organization if it is to be done successfully.

Risks and Rewards

International pricing strategy in B2B markets isn't a simple issue. It involves questions of organization, commercial policy and day-to-day operations. It demands a holistic response on a companywide basis to create and implement a solution which eliminates risk and delivers enhanced profitability. It requires an approach which can separate pressing operational needs from strategic considerations and give the necessary focus to each of them to develop solutions which will achieve medium to long term goals without sacrificing short term results. Inaction may seem the most attractive option in a turbulent market, but it could result in significant impact on the bottom line. Component Manufacturers which take action to manage cross border pricing in Europe will not only be best placed to respond to short term challenges, but well positioned to thrive in the medium to long term.

Management3 is a strategic consultancy committed to delivering results and increased profitability for our clients; we focus on customers, channels and market strategies to help them optimize their businesses. The Managing Partners, Neil Fryer and Marco Bicocchi Pichi, have significant managerial experience as well as consultancy competences; our deep knowledge of the automotive aftermarket makes Management3 a business partner which can leverage its expertise to benefit your business. Contact us for more information on the services we offer.

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