Chapter 7

Pricing in International Trade

Price is an important factor in determining a firm's ability to compete in world markets. For many companies, pricing policies and procedures are secret information and not easily available to outsiders. Export prices should be high enough to make a reasonable profit and yet low enough to be competitive in the market. Products rarely sell on one factor alone, and the exporter should be competitive on nonprice factors of different kinds. Sources of nonprice competition include reliable delivery, short delivery time, product reliability, and product quality, as well as any other feature considered unique by customers. This form of product differentiation based on specific characteristics of a product or service gives firms a competitive advantage (Dussauge, Hart, and Ramanantsoa, 1987). Apple Computer increased its market share in Japan not only by slashing prices but also by broadening distribution outlets and through the addition of Japanese software packages.

The crucial element in determining price relates to the value consumers place on the product. Value results from consumers' perceptions of the total satisfaction provided by the product (Hiam and Schewe, 1992). Companies can charge high prices and manage to remain competitive if the price charged is lower than, or in alignment with, the perceived value of the product or service. In competitive markets, high prices represent an indication of the social desirability of producing the product or service. They may also be justified in export markets if the sale also involves transfers of technology or training.

Pricing in world markets is often used as an instrument of accomplishing the firm's marketing objectives. The firm could use price to achieve certain levels of market share, profits, or returns on investments, or to reach some other specific goal. The following policies for pricing and markups generally apply to both domestic and export markets:

- High markups are common in industries with relatively few competitors. Markups are also higher in industries in which companies produce differentiated products rather than homogeneous ones. The high markups could be taken as rent arising from market power. For example, in the chemical industry, the biggest profits lie in specialty chemicals designed and produced for particular industrial uses (Reich, 1991). High markups may also be due to R & D expenditures and costs of increasing the skills of the workforce.
- Export prices tend to be relatively low in sectors in which there is increased competition. Changes in competitors' prices or the state of demand are more likely to trigger a reduction in export prices. Markups are relatively low for textiles, food, electric machinery, and motor vehicles; they remain high in industries such as medicines, computers, industrial chemicals, and television and communications equipment (Martens, Scarpetta, and Pilat, 1996). The low markups for the former are due to the fragmented and nondifferentiated nature of these industries, which makes it difficult to exercise market power.

A company needs to develop a workable guideline with respect to pricing of its product or service in export markets. Its pricing policy should be firm enough to achieve the targeted level of profits or sales, while maintaining some flexibility to accommodate the overall marketing objectives of the firm. Flexibility is seen as an absolute necessity for optimizing profits, and a firm may use all pricing methods according to the type of product being sold, the class and type of customer, and the competitive situation in the marketplace. Mismanagement of export pricing could often lead to pressures for price reductions or the development of parallel markets. Parallel, or gray, markets are created when the product is purchased at a low price in one market and sold in other markets enjoying higher prices. For example, Eastman Kodak prices its films higher in Japan than in other countries. An importer in Japan can purchase the product at a discount in a foreign country and sell it in the Japanese market at a price lower than that charged by authorized Kodak dealers. Appropriate pricing and control systems of quality and distribution outlets are important in reducing such incidences of parallel markets.

DETERMINANTS OF EXPORT PRICES

A number of variables influence the level of export prices. Some of these are internal to the firm; others are factors that are external to the firm. A major internal variable is the cost that is to be included in the export price. The typical costs associated with exports include market research, credit checks, business travel, product modification, special packaging, consultants, freight forwarders, and commissions (Anonymous, 1993). An additional cost is the chosen system of distribution. The long distribution channels in many countries are often responsible for price escalation. The use of manufacturers' representatives offers greater price control to the exporter. Another internal variable is the degree of product differentiation, that is, the extent of a product's perceived uniqueness or continuance of service. Generally, the higher the product differentiation a firm enjoys, the more independent it can be in its price-setting activities.

The external forces that influence export pricing include the following:

- *Supply and demand:* The pricing decisions for exports are subject to the influence of the supply of raw materials, parts, and other inputs. In a competitive economy, any increase in demand is followed by a higher price, and the higher price should, in turn, moderate demand. It is often stated that exports of manufactured goods exhibit the same price characteristic as primary products, their prices varying with the state of world demand and supply (Silberston, 1970). The classical supply-and-demand approach—whereby price acts as an allocating device in the economy and supply equals demand at an equilibrium price—is largely based on certain assumptions: perfect buyer information, substitutability of competing goods, and marginal cost pricing. The classical assumption that reducing prices increases demand ignores the interpretation of price changes by buyers. Studies have shown that consumers perceive price as an indicator of quality and may interpret lower product prices as a sign of poor quality (Piercy, 1982). If a product has a prestigious image, price can be increased without necessarily reducing demand.
- *Location and environment of the foreign market:* Climatic conditions often require product modification in different markets, and this is reflected in the price of the export product. Goods that deteriorate in high-humidity conditions require special, more expensive packaging. For example, engines that are to be exported to countries in the tropics require extra cooling capacity.
- *Economic policies such as exchange rates, price controls, and tariffs also influence export pricing:* Exchange rate depreciation (a drop in the value of a currency) improves price competitiveness, thus leading to increased export volumes and market shares. For example, in 1984 to 1985, when the dollar had appreciated to roughly double its 1980

value against the German mark, luxury German cars were selling for lower prices in the United States than in Germany. In export markets where buyers are used to negotiating prices, a flexible price is preferable over one that uniformly applies to all buyers.

- *Government regulations in the home country:* Different regulations in the home country have a bearing on export pricing. For example, U.S. government action to reduce the impact of its antitrust laws on competition abroad has enhanced the price competitiveness of American companies.

PRICING IN EXPORT MARKETS

The export price decision is distinct from the domestic price decision in the home market. The export decision has to consider variations in market conditions, existence of cartels or trade associations, and the existence of different channels of distribution. The presence of different environmental variables in export markets militates against the adoption of a single export-pricing policy (ethnocentric pricing) around the world. Another factor against uniform pricing is that different markets may be at different stages in the life cycle of a product at any given time.

It is customary to charge a high price during the introduction and growth stages of a product and to progressively reduce the price as the product matures. Other pricing alternatives include (1) polycentric pricing, which is pricing sensitive to local conditions, and (2) geocentric pricing, whereby a firm strikes an intermediate position. There are four approaches to export pricing.

Cost-Based Pricing

The most common pricing approach used by exporters is one that is based on full-cost-oriented pricing. Under this procedure, a markup rate on full cost is determined and then added to the product's cost to establish the price. The markup rate could be based on the desired target rate of return on investment.

The Marginal Approach to Pricing

Marginal pricing is more common in exporting than in domestic markets. It is often employed by businesses that have unused capacity or to gain market share. In this case, the price does not cover the product's total cost, but instead includes only the marginal (variable) cost of producing the product to be sold in the export market. This will result in the sale of a product at a lower price in the export market than at home and often leads to charges of dumping by competitors.

Skimming versus Penetration Pricing

Skimming, or charging a premium price for a product, is common in industries that have few competitors or in which the companies produce differentiated products. Such products are directed to the high-income, price-inelastic segment of the market.

Penetration-pricing policy is based on charging lower prices for exports to stimulate market growth. Increasing market share and maximizing revenues could generate high profits.

Demand-Based Pricing

Under this method, export prices are based on what consumers or industrial buyers are willing to pay for the product or service. When prices are set by demand, market surveys will help supply the data to identify the level of demand. The level of demand generally establishes the range of prices that will be acceptable to customers. Companies often test-market a product at various prices and settle on a price that results in the greatest sales.

A firm does not have to sell a product at or below market price to be competitive in export markets. A superior or unique product can command a higher price. Cartier watches and Levi's jeans are examples of products that, despite their high prices, generate enormous sales worldwide due to their reputation. These are products for which consumers feel a strong demand and for which there are few, or no, substitutes (products with inelastic demand). In cases in which demand for the product is elastic, consumers are sensitive to changes in price. For example, rebates and other discount schemes often revive lagging export sales in the auto industry (which is characterized by elastic demand). A few years ago, Toyota launched a special sales campaign in Tokyo to give away money (about one million yen to 100 customers) to some of the customers of the competitor car it sells in Japan on behalf of General Motors.

Competitive Pricing

Competitive pressures are important in setting prices in export markets. In this case, export prices are established by maintaining the same price level as the competition, reducing prices or increasing the price with some level of product improvement. However, price-cutting is generally a more effective strategy for small competitors than for dominant firms. An important factor in establishing a pricing strategy is also a projection of likely responses of existing and potential competitors (Oster, 1990).

TERMS OF SALE

Despite wide differences among national laws, there is a high degree of uniformity in contract practices for the export and import of goods. The universality of trade practices, including terms of sale, is due to the development of the law merchant by international mercantile custom. The law merchant refers to the body of commercial law that developed in Europe during the medieval period for merchants and their merchandise (Brinton et al., 1984).

Trade terms are intended to define the method of delivery of the goods sold and the attendant responsibilities of the parties. Such terms also help the seller in the calculation of the purchase price (Anonymous, 1993). A seller quoting the term of sale as FOB, for example, will evidently charge a lower price than if quoting CIF because the latter includes not only the cost of goods but also expenses incurred by the seller for insurance and freight to ship the goods to the port of destination. The national laws of each country often determine the rights and duties of parties with respect to terms of sale. In the United States, the Revised American Foreign Trade Definitions (1941) and The Uniform Commercial Code govern terms of sale. Since 1980, the sponsors of the Revised American Foreign Trade Definitions recommend the use of Incoterms. Parties to terms of sale could also agree to be governed by Incoterms, published by the International Chamber of Commerce in 1953 (latest revision, 2000, which now enjoys almost universal acceptance [Herman, 1989]). The ICC is a nongovernmental entity. Incoterms is neither a national legislation nor an international treaty. It applies when the parties expressly indicate their intention to incorporate it into their export sales contract. If the parties do not explicitly agree to be governed by Incoterms, it could be made an implicit term of the contract as part of international custom.

Incoterms are periodically revised every ten years to represent contemporary commercial practice (Incoterms, 1980, 1990, 2000). In order to avoid any misunderstanding, parties to export contracts should always state the application of the current version of Incoterms. The Uniform Commercial Code (UCC) and Incoterms complement each other in many areas. Trade terms are not understood in the same manner in every country and it is important to explicitly state the law that governs the contract. For example, a contract should state FOB New York (Incoterms) or “CIF Liverpool (Uniform Commercial Code)” (see Table 7.1).

TABLE 7.1. Major Differences Between Incoterms, 2000 and Uniform Commercial Code (UCC)

Terms of Sale	Incoterms, 2000	UCC
Commercial terms	There are many new commercial terms in Incoterms which are not found in UCC (FCA, CPT, CIP, DAF, DES, DEQ, DDU, DDP)	Many of the new terms in Incoterms are generally covered by existing UCC terms (Using a different name, definition, etc.)
Ex Works	Seller needs only to tender the goods to buyer by placing them at the buyer's disposal at a named place of delivery and notifying the buyer the time/place. The seller has no obligation to deliver the goods to carrier or load them on a vehicle. The seller has no obligation to arrange transportation or insurance	Where a third party carrier is not involved, risk of loss passes not upon mere tender of delivery but when buyer receives the goods. There is no provision for transportation and insurance. When third party carrier is involved, transfer of risk occurs upon tender of goods to enable buyer to take delivery. It requires seller to arrange for transportation and insurance
FOB	Exclusively used for waterborne transportation	Not exclusive to waterborne transportation unless it is FOB (vessel). In FOB (place of shipment) seller arranges for transportation and insurance. UCC's FOB (place of destination) is equivalent to DDU term under Incoterms
	FCA (Incoterms), seller arranges for transportation only in special circumstances. There is no obligation for insurance	UCC's FOB (place of shipment) equivalent to FCA under Incoterms
	There is no requirement for payment against documents	Requires payment against documents
FAS and CIF	There is no requirement for payment against document or use of negotiable bill of lading	UCC requires payments against tender of documents

All trade terms are classified into four groups based on the point of transfer of risk (delivery) from seller to buyer (see Table 7.2):

1. *Group E term (Ex Works):* This grouping has only one term and represents the seller's minimum obligation, that is, to place the goods at the disposal of the buyer. There are no contractual arrangements between seller and buyer with regard to insurance, transportation, or export.

2. *Group F terms (FCA, FAS, FOB):* The seller is expected to bear the risk and expense of delivery to a nominated carrier. It is the buyer's responsibility to arrange and pay for the main carriage to the point of destination.
3. *Group C terms (CRF, CIF, CPT, CIP):* C-terms establish the point of delivery (transfer of risk) from seller to buyer at the point of shipment. However, it extends the seller's obligation with regard to the costs of carriage and insurance up to the point of destination. This means that the seller bears certain costs even after the critical point for the division of the risk or damage to the goods. They are often referred to as shipment terms.
4. *Group D terms (DAF, DES, DEQ, DDU, DDP):* The seller's delivery obligation extends to the country of destination. This means that the seller could be held liable for breach of contract if the goods are lost/damaged after shipment but before arrival at the agreed point of destination. The seller may be required to provide substitute goods or other forms of restitution to the buyer. They are often referred to as arrival terms (see Table 7.3).

Group E (Ex Works, Ex Warehouse, and Ex Store)

Ex Works, Ex Warehouse, Ex Store (named place): Under this term, the buyer or agent must collect the goods at the seller's works, warehouse, or store. The seller bears all risk and expenses until the goods are placed at the

TABLE 7.2. Group of Incoterms, 2000

Group E (Departure)	Group F Main Carriage Unpaid	Group C Main Carriage Paid (Shipment Terms)	Group D Arrival Terms
Ex Works (EXW) (AMT)[a]	Free Carrier (FCA) (AMT) Free Alongside Ship (FAS) (STO)[a] Free on Board (FOB) (STO)	Cost and Freight (CFR) (STO) Cost, Insurance and Freight (CIF) (STO) Carriage Paid To (CPT) (AMT) Carriage and Insurance Paid To (CIP) (AMT)	Delivered at Frontier (DAF) (AMT) Delivered Ex Ship (DES) (STO) Delivered Ex Quay (DEQ) (STO) Delivered Duty Unpaid (DDU) (AMT) Delivered Duty Paid (DDP) (AMT)

[a]AMT: All modes of transport; STO: Sea transport only.

TABLE 7.3A. Responsibilities of Parties under Incoterms, 2000

	Sea Transport Only					
Responsibility	***FAS***	***FOB***	***CFR***	***CIF***	***DES***	***DEQ***
Loading at seller's premises	SR	SR	SR	SR	SR	SR
Domestic precarriage (local cartage)	SR	SR	SR	SR	SR	SR
Contract of carriage and dispatch	BR	SR	SR	SR	SR	SR
Trade documentation (country of export)	SR	SR	SR	SR	SR	SR
Customs clearance (country of export)	SR	SR	SR	SR	SR	SR
Export charges	SR	SR	SR	SR	SR	SR
Transshipment at carrier's terminal	BR	BR	SR	SR	SR	SR
Transport (cargo) insurance				SR		
Int. main carriage	BR	BR	SR	SR	SR	SR
Transshipment at terminal	BR	BR	SR	SR	BR	SR
Trade documentation (country of transit/ import)	BR	BR	BR	BR	BR	BR
Customs clearance (country of import)	BR	BR	BR	BR	BR	BR
Import charges	BR	BR	BR	BR	BR	BR
Local cartage/domestic oncarriage	BR	BR	BR	BR	BR	BR
Unloading at buyer's premises	BR	BR	BR	BR	BR	BR

disposal of the buyer at the time and place agreed for delivery, normally the seller's premises, warehouse, or factory. The purchase price becomes payable at the time of delivery.

Risk is not transferred to buyer if damage or loss is attributed to the failure on the part of the seller to deliver the goods in conformity with the contract (e.g., damage due to inadequate packing of goods).

The buyer bears all risk and charges pertaining to preshipment inspection, export/import licenses, and customs duties/taxes needed for exportation. The buyer is also responsible for clearance of goods for exports, transit, and imports since the seller makes the goods available to the buyer in the country of export.

This term of sale is similar to a domestic sales transaction, although the product is destined for export.

Group F (FCA, FAS, and FOB)

Free carrier (FCA), named place: The seller bears the risk and costs relating to the goods until delivery to the carrier or any other person nominated by the buyer. The place of delivery could be the carrier's cargo terminal or a vehicle sent to pick up the goods at the seller's premises. The seller is

TABLE 7.3B. Responsibilities of Parties under Incoterms, 2000

	All Modes of Transport															
Responsibility	***EXW***	***FCA1***	***FCA2***	***CPT1***	***CIP1***	***CPT2***	***CIP2***	***CPT3***	***CIP3***	***CPT4***	***CIP4***	***DAF***	***DDU1***	***DDP1***	***DDU2***	***DDP2***
Loading at seller's premises	BR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Domestic precarriage (local cartage)	BR	BR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Contract of carriage and dispatch	BR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Trade documentation (country of export)	BR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Customs clearance (country of export)	BR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Export charges	BR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Transshipment at carrier's terminal	BR	BR	BR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Transport (cargo) insurance				SR			SR		SR		SR					
Int. main carriage	BR	BR	BR	SR/ BR	SR/ BR	SR/ BR	SR/ BR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Transshipment at terminal	BR	BR	BR	BR	BR	BR	BR	SR	SR	SR	SR	SR	SR	SR	SR	SR

TABLE 7.3B *(continued)*

	All Modes of Transport															
	EXW	***FCA1***	***FCA2***	***CPT1***	***CIP1***	***CPT2***	***CIP2***	***CPT3***	***CIP3***	***CPT4***	***CIP4***	***DAF***	***DDU1***	***DDP1***	***DDU2***	***DDP2***
Trade documentation (country of transit/ import)	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	SR	BR	SR
Customs clearance (country of import)	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	SR	BR	SR
Import charges	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	SR	BR	SR
Local cartage/domestic on carriage	BR	BR	BR	BR	BR	BR	BR	BR	BR	SR	SR	BR	BR	BR	SR	SR
Unloading at buyer's premises	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR	BR

CIP1: Carriage and Insurance Paid To (named frontier point in country of dispatch); CIP2: Carriage and Ins. Paid To (named frontier point in country of destination); CIP3: Carriage and Ins. Paid To (named terminal); CIP4: Carriage and Ins. Paid to buyer's premises; CPT1: Carriage Paid To(named frontier point in country of dispatch); CPT2: Carriage Paid To (named frontier point in country of destination); CPT3: Carriage Paid To (named terminal); CPT4: Carriage Paid to buyer's premises; DDP1: Delivered (named terminal) Duty Paid, exclusive of (named tax); DDP2: Delivered buyer's premises Duty Paid, exclusive of (named tax); DDU1: Delivered (named terminal) Duty Unpaid; DDU2: Delivered buyer's premises Duty Unpaid; FCA1: Free carrier seller's premises; FCA2: Free carrier (named terminal).

responsible for loading the goods onto the buyer's collecting vehicle. If the place of delivery is the carrier's cargo terminal, the seller is only required to bring the goods to the terminal (not obligated to unload them). It is sought that the carrier is likely to have the necessary personnel and equipment to unload the goods at its own terminal rather than the seller.

Upon delivery of the goods to the carrier, the seller receives (from the carrier) a receipt, which serves as evidence of delivery and contract of carriage made on behalf of the buyer. Neither party is required to insure under FCA. However, the seller must provide the buyer (upon request) with the necessary information for procuring insurance.

Besides payment of the purchase price as provided in the contract, the buyer has the following obligations:

- Obtain at his or her own risk and expense any import license and other official authorization necessary for importation of the goods as well as for their transit through another country.
- Contract at his or her own expense for carriage of the goods from the named place of delivery.
- Pay the costs of any preshipment inspection except when such inspection is mandated by exporting country.

Free alongside ship (FAS), named port of shipment: This term requires the seller to deliver the goods to a named port alongside a vessel to be designated by the buyer (ICC, 2000). "Alongside the vessel" has been understood to mean that the goods be within reach of a ship's lifting tackle. The risks to the goods pass to the buyer upon seller's delivery alongside the ship. This implies that all charges and risks for the goods are borne by the buyer from the time they have been effectively delivered alongside the vessel.

The seller must obtain at his own risk and expense any export license and other official authorizations, including customs formalities that are necessary for the export of the goods. The seller's obligation to clear the goods for export is similar to that of FOB contracts. There is an implied duty on the part of the seller to cooperate in arranging a loading and shipping schedule, and to render at the buyer's request and expense every assistance in obtaining necessary documents for the import of the goods and their transit through another country. The seller must provide the buyer (at his or her own expense) with the usual proof of delivery.

The buyer must contract (at his or her own expense) for the carriage of goods from the port of shipment. Since the buyer has to nominate the ship, he or she has to pay any additional costs incurred if the named vessel fails to arrive on time or the vessel is unable to take the goods. In such cases, a premature passing of risk will occur. Costs of any preshipment inspection are borne by the buyer except when such inspection is mandated by the exporting country.

The use of FAS is appropriate in cases where sellers took their shipment to the pier and deposited it close enough for loading. However, today most of the outbound cargo is delivered to ship lines days before placement alongside the vessel. It is also not applicable in cases of rolling cargo (cars, trucks) that can be driven aboard vessel, or in ports with shallow harbors that do not allow for vessels to come alongside the pier.

Free on board (FOB), named port of shipment: The central feature of FOB contracts is the notion that the seller undertakes to place the goods on board the ship designated by the buyer. This includes responsibility for all charges incurred up to and including delivery of the goods over the ship's rail at the named port of shipment (ICC, 2000). The buyer has to nominate a suitable ship and inform the seller of its name, loading point, and delivery time. If the ship that was originally nominated is unable or unavailable to receive the cargo at the agreed time for loading, the buyer has to nominate a substitute ship and pay all additional charges. Once the seller delivers the goods on board the ship, the buyer is responsible for all subsequent charges such as freight, marine insurance, unloading charges, import duties, and other expenses due on arrival at the port of destination. Unless otherwise stated in the contract of sale, it is customary in FOB contracts for the seller to procure the export license and other formalities necessary for the export of the goods since the latter is more familiar with licensing practices and procedures in the exporting country than the buyer. Transfer of risk occurs upon seller's delivery of the goods on board the vessel. Seller's responsibility for loss or damage to the goods terminates on delivery to the carrier. The ship's rail is thus considered the dividing line between the seller's and buyer's responsibility in terms of transfer of risk (see Table 7.4).

Free on board does not appear to be consistent with current practice except for shipments of noncontainerized or bulk cargo, as well as shipments by chartered vessel. In many other cases, sellers are required to deliver their outbound cargo to ship lines days before actual loading of the cargo. The seller, however, remains responsible for the goods until delivery on board the vessel (see International Perspectives 7.1 and 7.2).

Group C (CIF, CFR, CPT, and CIP)

Cost, insurance, and freight (CIF), named port of destination: The CIF contract places upon the seller the obligation to arrange for shipment of the goods. The seller has to ship goods described under the contract to be delivered at the destination and arrange for insurance to be available for the

TABLE 7.4. Price Determination Worksheet (UCC)

Price (or cost) per unit _____ 3 ____ unites 5 total	1
Profit (or mark up)	1
Commissions	1
Financing costs	1
Ex factory	5
Crating/containerization charges (if done at factory)	1
Labeling and marking costs (if done at factory)	1
Drayage charges (usually associated with movement of containers from railroad ramp to plant and back to ramp)	1
Loading charges, if applicable	1
Demurrage and detention charges, if applicable	1
Other charges (specify)	1
Free on board (FOB) truck or rail car at point of origin	5
Inland freight charges (including fuel surcharges)	1
Unloading charges at port facilities	1
Drayage to packer (crater/containerized), if applicable	1
Containerization/crating charges (if done at port)	1
Labeling and marking (if done at port)	1
Freight forwarding and documentation charges (includes charges associated with consular fees, export license, postage, telex, and telephone/telegram use, etc.)	1
Drayage to warehouse and unloading, if applicable	1
Warehousing charges, if applicable	1
Loading and drayage to pier from packer or warehouse, if applicable	1
Wharfage charges	1
Terminal notification charges	1
Demurrage/detention at port	1
Free alongside vessel at port of __________	5
Vessel loading charges	1
Heavy lift or extra-length charges, if applicable	1
Other charges (specify)	1
Free on board vessel at port of __________	5
Ocean freight charges	1
Bunker or other surcharges, if applicable	1
Cost and freight to ___________	5
Insurance	1
Cost, insurance and freight to __________	5

benefit of the buyer or any other person with insurable interest in the goods. In the absence of express agreement, the insurance shall be in accordance with minimum of cover provided under the Institute of Cargo Clauses or similar set of guidelines. The cost of freight is borne by the seller and the

INTERNATIONAL PERSPECTIVE 7.1.
Incoterms: Salient Features

A. *Incoterms 1990 versus Incoterms 2000:* Important differences:

- Incoterms 2000 places the responsibility for export clearance on the seller in FAS contracts. This obligation was borne by the buyer in Incoterms 1990.
- Incoterms 2000 requires the buyer to clear imports at his or her own expense (seller's responsibility in Incoterms 1990) under delivered at quay (DEQ) term.
- Incoterms 2000 obligates the seller to load the goods on the buyer's collecting vehicle under FCA term. In Incoterms 1990, the seller is not responsible for placing the goods on board the carrier (plane, truck, etc.) nominated by the buyer.

B. *Recognizing the limitation of Incoterms:* Incoterms only deal with matters pertaining to the interpretation of terms of delivery. The rules do not deal with transfer of property rights in the goods, exemptions from liability, or consequences in cases of breach of contract. They deal with obligations in connection with delivery, provision of documents, insurance, and clearance of goods for export/import operations.

C. *Thirteen terms in Incoterms 2000:* Incoterms attempts to reflect contemporary commercial practice and offers a variety of terms ranging from Ex Works, which entails minimal obligation for the seller to extended obligations (FCA, FAS, FOB). It also provides for maximum obligations for the seller (DAF, DES, DEQ, DDU, DDP). Incoterms are often used in contracts of sale and contracts of carriage.

D. *Insurance:* Seller's obligation to take out insurance to the benefit of the buyer applies only under CIP and CIF terms. Parties have to arrange insurance as they see fit under all other terms.

buyer undertakes to pay upon arrival of the merchandise (ICC, 2000). The seller must notify the buyer that the goods have been delivered on board the vessel to enable the buyer to receive the goods.

The seller has to tender the necessary documents (commercial invoice, bill of lading, policy of insurance) to the buyer so that the latter could obtain delivery upon arrival of the goods or recover for their loss. The buyer must accept the documents when tendered by the seller when they are in conformity with the contract of sale and pay the purchase price. Import duties/licenses, consular fees, and charges to procure a certificate of origin are the responsibility of the buyer, while export licenses and other customs formalities necessary for the export of the goods have to be obtained by the seller.

INTERNATIONAL PERSPECTIVE 7.2.
Incoterms and Business Strategies

- *Which Incoterms are appropriate?* The choice is dependent on the type of cargo and the buyer's intention to sell the goods in transit. It also depends on the ability of the parties to obtain the most favorable contract of carriage.
- *Appropriateness of C versus F term:* In cases where the seller can procure marine insurance at a competitive price and where there are government regulations to use national shipping lines, it may be appropriate to use CFR and CIF. If the parties prefer the seller to procure carriage (CPT) and insurance, CIP may be appropriate. When the buyer can procure insurance at a competitive rate, the parties may prefer to use FAS or FOB.
- *Manufactured goods:* Exporters of manufactured goods often sell on extended terms using DDU and DDP (seller makes goods available to buyer at the cargo terminal) to remain competitive. Since such goods are normally containerized, the parties can also use FCA, CPT, or CIP.
- *Use of Ex Works, FCA:* Large buyers such as wholesalers, department stores may find it advantageous to arrange for transportation in order to ensure just-in-time deliveries.

The CIF contract may provide certain advantages to the overseas customer because the seller often possesses expert knowledge and experience to make favorable arrangements with respect to freight, insurance, and other charges. This could be reflected in terms of reduced import prices for the overseas customer (see Table 7.5).

Under a CIF contract, risk passes to the buyer upon delivery, that is, when the goods are put on board the ship at the port of departure.

Rejection of documents versus rejection of goods: When proper shipping documents that are in conformity with the contract are tendered, the buyer must accept them and pay the purchase price. The right to reject the goods arises when they are landed and, after examination, they are found not to be in conformity with the contract. It may also happen that while the goods conform to the contract, the documents are not in accordance with the contract of sale (discrepancies between documents such as bill of lading, commercial invoice, draft and the letter of credit, or contract of sale). In this case, the buyer could accept the goods but reject the documents and claim damages for a breach of condition relating to the goods. Thus, under a CIF contract, the right to reject the documents is separate and distinct from the right to reject the goods.

TABLE 7.5. Items to Be Included in the Calculation of the Price Using Various Terms and Required Documents

	Incoterms, 2000													
	Ex Works	**FCA[1]**	**FCA[2]**	**FAS**	**FOB**	**CPT**	**CIP**	**CFR**	**CIF**	**DAF**	**DDU**	**DDP**	**DES**	**DEQ**
Invoice Items														
Total items	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Export packing				x	x									
Precarriage[a]			x	x	x			x	x	x			x	x
Vessel loading													x	x
Main carriage[b]								x	x				x	x
Forwarding fees						x	x	x	x					
Total carriage						x	x				x	x		
Insurance							x		x					x
Unloading														
Total	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Required Documents														
Commercial invoice	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Buyer's receipt	x													
Delivery receipt[c]		x	x										x	x
Export license		x	x	x	x	x	x	x	x					
Clean receipt[d]				x	x									
Transport document						x	x	x	x	x				
Insurance							x		x					

TABLE 7.5 *(continued)*

	Incoterms, 2000													
	Ex Works	**FCA[1]**	**FCA[2]**	**FAS**	**FOB**	**CPT**	**CIP**	**CFR**	**CIF**	**DAF**	**DDU**	**DDP**	**DES**	**DEQ**
Document to take Delivery														
Import license												x		
Suggested Payment Terms														
Cash in advance	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Letter of credit		x	x	x	x	x	x	x	x		x		x	x
Documentary collection		x	x	x	x	x	x	x	x		x		x	x
Open account	x	x	x	x	x	x	x	x	x	x	x	x	x	x

Note: CIA: Cash in advance; L/C: Letter of credit; DD: Documentary draft; OA: Open account.

[1]Seller's place

[2]Carrier's terminal

[a]precarriage: inland freight to the point of departure i.e., port etc.

[b]Main carriage: Transportation to the overseas customer, normally by air or ship

[c]delivery receipt: certificate of carriage given by carrier

[d]clean receipt: receipt by carrier to show that the goods bear no damage or loss.

Payment is often made against documents. Tender of the goods cannot be an alternative to tender of the documents in CIF contracts. The buyer's acceptance of conforming documents does not impair subsequent rejection of the goods and recovery of the purchase price if on arrival the goods are not in accordance with the terms of sale.

Loss of goods: If the goods shipped under a CIF contract are destroyed or lost during transit, the seller is entitled to claim the purchase price against presentation of proper shipping documents to the buyer. Since insurance is taken for the benefit of the buyer, the buyer can claim against the insurer in so far as the risk is covered by the policy. If the loss is due to some misconduct on the part of the carrier not covered by the policy, the buyer could recover from the carrier.

The only difference between CIF and CFR terms is that the latter does not require the seller to obtain and pay for cargo insurance.

Carriage paid to (CPT), named place of destination is similar to the CFR term, except that it may be used for any other type of transportation. Even though the seller is obligated to arrange and pay for the transportation to a named place of destination, he or she completes delivery obligations and thus transfers risk of loss/damage to the buyer when the goods are delivered to the carrier at the place of shipment.

The seller must notify the buyer that the goods have been delivered to the carrier (first carrier in the case of multimodal transportation) and also give any other notice required to enable the buyer to take receipt of the goods. The term is appropriate for multimodal transportation. When several carriers are involved (e.g., carriage by road or rail from the seller's warehouse for further carriage by sea to the destination), the seller has fulfilled his or her delivery obligation under CPT term when the goods have been handed over for carriage to the first carrier. In CFR and CIF contracts, delivery is not completed until the goods have reached a vessel at the port of shipment.

In the absence of an explicit agreement between the parties, there is no requirement to provide a negotiable bill of lading (to enable the buyer to sell the goods in transit). The buyer must pay the costs of any preshipment inspection unless such inspection is mandated by the exporting country. Given the absence of postinspection provisions in the Incoterms 2000, the CPT does not appear to restrict inspection before payment.

The CPT term is similar to the CIP term, except that the seller is not required to arrange or pay for insurance coverage of the goods during transportation.

Group D (DAF, DES, DEQ, DDU, and DDP)

Among the Group D terms, delivery Ex Quay (DEQ) and delivery Ex Ship are used for waterborne transportation while the other three can be used for any type of transportation including multimodal transport. All D terms share certain common features:

1. They are arrival/destination terms.
2. The seller is required to arrange for transportation, pay freight, and bear the risk of loss to a named point of destination.
3. The seller must place the goods at the disposal of the buyer (varies according to term).
4. There is no requirement for use of negotiable bill of lading and delivery occurs only after arrival of the goods.
5. Incoterms do not require insurance during transportation. Seller may have to arrange and pay for insurance or act as self-insurer during transportation.
6. The buyer must pay the costs of any preshipment inspection except when such inspection is mandated by the exporting country. There are no provisions for postshipment inspection.

Delivery at frontier (DAF), named place: DAF is frequently used in continental export trade (USA-Canada) where rail or road transportation is involved. It should specify not only the frontier but also the place of delivery (e.g., delivered at U.S.–Canada frontier, Vancouver). The frontier refers to a geographical or customs frontier. It can be that of the country of export, import, or some intermediate frontier.

The seller's obligations under DAF term have been defined as follows:

- To obtain at his or her own expense any export license and other documents necessary for placing the goods at the buyer's disposal
- To contract at his or her own expense for the carriage of the goods to the named point at the place of delivery at the frontier.
- To place the goods at the disposal of the buyer on the arriving means of transport, not unloaded at the named place of delivery. The risk of loss is on the seller until the goods reach the place of delivery at the frontier. The risk of loss passes to the buyer on arrival, without unloading. If there is no designated place of delivery, it may be determined by customs. (Incoterms, 2000)
- To provide the buyer (at seller's expense) with the necessary documents to enable the latter to take delivery of the goods (invoice, export

license, transport document). The seller must provide customary packaging which is required for the delivery of the goods at the frontier.

The buyer must bear all risk of loss or damage to the goods from the time they have been delivered at the frontier.

Delivery ex ship (DES), named port of destination: The DES term is applied only for waterborne transportation and almost always used with charter vessels. The seller is responsible for the carriage of the goods to the named port of destination. Transfer of risk from seller to buyer occurs when the goods are placed at the buyer's disposal on board ship at the named port of destination. The seller delivers when the goods are placed at the disposal of the buyer on board the vessel not cleared for import at the named port of destination. This means that the seller bears all the risk and expense involved in bringing the goods to the named port of destination (before discharging) that is, the goods should be made available to the buyer on board the vessel at the unloading point to enable them to be removed from the vessel by unloading equipment.

The seller is also obligated to notify buyer of the estimated time of arrival of the vessel and provide the necessary documents, such as invoice and bill of lading, as well as procure export license and other customs familiarities necessary for the export of the goods and their transit through another country. The buyer is responsible for unloading the goods and import clearance.

Delivered ex quay (DEQ), named port of destination: The DEQ term is used for waterborne transportation. A central feature of this term is that the seller arranges and pays for transportation to the named port of destination. Delivery occurs when the goods are placed at the buyer's disposal on the quay or wharf at the named port of destination, that is, the seller discharges goods on the quay or wharf. The buyer is required to clear the goods for import and handle other formalities and charges necessary for importation. With regard to other issues such as notice to buyer, provision of documents, packing, etc., it is similar to DES term. If the parties wish to extend the seller's obligations to handling of the goods (risk and expense to be incurred by the seller) from the quay to a warehouse or terminal in or outside the port of destination, it is appropriate to use delivery duty paid (DDP) or delivery duty unpaid (DDU) term. In DDP, delivery occurs when the goods are placed at the buyer's disposal on any means of transport not unloaded at the named port of destination. Unlike DDU, the seller pays for import duties and other charges necessary for importation at the port of destination. In other areas, such as notice to the buyer, provision of documents, packing, the DEQ term is similar to DDU and DDP terms.

The major differences between arrival contracts and a CIF contract are as follows:

- In arrival contracts, delivery is effected when the goods are placed at the disposal of the buyer. In CIF term, delivery is effected upon loading the goods on board the vessel at the port of departure.
- In arrival contracts, the buyer is under no obligation to pay the purchase price if the goods are lost on transit. In CIF contracts, the buyer is required to pay against documents. However, the loss of goods gives the buyer the right of claim from the carrier or the insurance company depending on the circumstances.

CHAPTER SUMMARY

Sources of Export Competitiveness

Price and nonprice factors such as reliable delivery, short delivery time, product reliability, product quality, design flexibility, support services, financial services

Export Pricing Objectives

Market share, profits, a targeted level of return on investment

Pricing and Markup Policy

1. High markups are common in industries with relatively few competitors and which produce differentiated products.
2. Low markups are common in sectors of increased competition.

Determinants of Export Prices

Internal Variables

Cost of production, cost of market research, business travel, product modification and packing, consultants, freight forwarders, and level of product differentiation

External Variables

Supply and demand, location and environment of foreign market, and home country regulations

Approaches to Export Pricing

1. *Cost-based pricing:* Export price is based on full cost and markup or full cost plus a desired amount of return on investment.
2. *Marginal pricing:* Export price is based on the variable cost of producing the product.
3. *Skimming versus penetration pricing:* Price skimming is charging a premium price for a product; penetration pricing is based on charging lower prices for exports to increase market share.
4. *Demand-based pricing:* Export price is based on what the market could bear.
5. *Competitive pricing:* Export prices are based on competitive pressures in the market.

Groups of terms of sale, 2000

1. *Group E (Ex Works):* Buyer or agent must collect the goods at the seller's works or warehouse.
2. *Group F*
   A. *FCA, free carrier:* Place of delivery could be the carrier's cargo terminal (seller not obligated to unload) or a vehicle sent to pick up the goods at the seller's premises (seller required to load the goods on the vehicle).
   B. *FAS, free alongside ship (named port of shipment):* Requires the seller to deliver goods to a named port alongside a vessel to be designated by the buyer. Seller's responsibilities end upon delivery alongside the vessel.
   C. *FOB, free on board (named port of shipment):* Seller is obliged to deliver the goods on board a vessel to be designated by the buyer.
3. *Group C*
   A. *CIF, cost, insurance, freight:* This term requires the seller to arrange for carriage by sea and pay freight and insurance to a port of destination. Seller's obligations are complete (transfer of risk) when the goods are put on board the ship at the port of departure.
   B. *CFR, cost and freight:* It is similar to CIF term except that the seller is not obligated to arrange and pay for insurance.

C. *CPT, carriage paid to:* It is similar to CFR term except that it may be used for any mode of transportation.
D. *CIP, carriage and insurance paid to:* It is similar to CPT term except that the seller is required to arrange and pay for insurance.

4. *Group D*
A. *DAF, delivery at frontier:* Seller bears all risk of loss to the goods till the time they have been delivered to buyer at the frontier.
B. *DES, delivery ex ship:* Applied only for waterborne transportation. This term requires the seller to deliver goods to a buyer at an agreed port of arrival.
C. *DEQ, delivery ex quay:* Seller is required to deliver goods at the quay at the port of destination.
D. *DDP, delivered duty paid:* Goods placed at the buyer's disposal on any means of transport not unloaded at the port of arrival.
E. *DDU, delivered duty unpaid:* Similar to DDU except that the seller pays for import duties.

REVIEW QUESTIONS

1. High markups are common in industries with relatively few competitors. Discuss and provide examples.
2. The large influx of shrimp imports into the United States from Asia and Latin America depressed wholesale prices by over 40 percent between 1997 and 2002. Despite such lower prices, shrimp entrées at some seafood restaurants in the United States rose by about 28 percent during the same period. Discuss why prices (shrimp prices at sea food restaurants) are not aligned with costs.
3. What is the difference between marginal and cost-based pricing?
4. Seller agreed to deliver 300 tons of coffee to buyer DES port of Montreal, Canada. The goods were transported and unloaded at the port and kept at customs shed for inspection and payment of duties. The buyer was notified of the arrival of the merchandise and its location. Before the buyer picked up the goods, the customs shed (including the merchandise in it) was destroyed by fire. The buyer claims refund of the purchase price stating that she did not receive the goods. Is the seller responsible?
5. In reference to question 4, would the outcome be different if the contract had been DEQ port of Montreal?
6. Seller in New York agrees to ship goods to buyer in Lima, Peru, under a CIF contract. The goods were loaded on the ship and seller tendered the necessary documents to buyer for payment (in New

York). The buyer refused payment claiming that it will only pay after inspection upon arrival of the goods at the port of destination. Is the seller entitled to payment before arrival of the goods?
7. Discuss the major differences between CIF and arrival contracts such as DES.
8. State the major differences between Incoterms 1990 and Incoterms 2000.
9. What are the limitations of Incoterms? Compare and contrast Incoterms with the Uniform Commercial Code.
10. In what cases would export-import managers prefer to use Group C (shipment) terms?

CASE 7.1. INCOTERMS (CIF)

A contract of sale was entered between an American company, BAT, Inc., of Calumet City, Illinois (buyer), and a German scientific equipment manufacturing firm, Tola (seller), for the sale of a mobile MRI. Tola sent the requested MRI machine to buyer aboard the ship, *Superior Carrier,* in good working condition. However, when it reached its final destination, it had been damaged and was in need of extensive repair. The buyer and its insurance company believe that the MRI was damaged in transit. BAT's insurance company, St. Guardian Insurance, covered the cost of the damage, which was $350,000. In turn, the insurance company intends to recover from Tola. However, Tola claims that, since the goods were shipped under CIF (New York) term, they were under no obligation for the loss, that is, its contractual obligation with regard to risk of loss ended when it delivered the machine to the vessel at the port of shipment. The buyer (its insurance company) contends that Incoterms were inapplicable since they were not specifically incorporated into the contract. They also argue that the seller's explicit retention of title modified the risk of loss.

Question

1. Do you agree with BAT and St. Guardian Insurance? Why/why not?

CASE 7.2. INCOTERMS (C&F)

In August 2006, International Commodities Export Corporation (ICEC) entered into an agreement for the sale of 230 tons of Chinese white beans to North Pacific Lumber company (NPL). According to the agreement, the beans were to conform to sample pc-16 and the shipment was to be made on the basis of C&F. Thirteen separate containers of beans were loaded on board two vessels at the port of Hong Kong to Portland, Oregon. An independent surveyor of quality found the bean quality to be in conformity with the description of the goods in the shipper's invoice.

The U.S. Food and Drug Administration (FDA) detained the shipment on arrival in Portland, Oregon, on the grounds that the goods contained filth and were unfit for human consumption. The beans were stored in a warehouse under federal government detention. After efforts to obtain release of the cargo, the buyer rejected the shipments for failure to conform to the contract (sample pc-16).

Questions

1. Did title pass from seller to buyer? If so, when?
2. Is the seller responsible for the goods under C&F when the goods are on board the vessel? How about after delivery to buyer?