PRICING CONDITIONS IN THE EUROPEAN COMMON MARKET: AN EMPIRICAL CROSS-COUNTRY ANALYSIS

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Abstract

Pricing is a critical issue for firms operating in Europe. A structural analysis of the pricing conditions in three industries in six EC countries is performed and the implications for pan-European pricing are discussed. The analysis reveals that existing structural differences between countries are too large to be ignored. However, the internationalization of the retail industry across Europe is putting increasing pressure on consumer goods firms to align their prices. Finally, two strategic approaches to deal with this dilemma are presented.

1. EC '93: A Challenge for the Pricing of Consumer Goods

With the emergence of the Single European Market, many of the barriers between national markets are crumbling and, as a result, most industries are undergoing structural changes with wideranging implications on competition and strategy (Euler/Berqvist 1991). One of the challenges that consumer goods companies are confronted with in this context is the issue of pricing. Enormous price differentials exist for virtually identical products and it is of utmost strategic importance for survival and profitability of companies operating in the EC to know whether, to what degree and how these differences in prices can be sustained (Simon/Kucher 1992). One consumer goods company, for instance, was so exposed through its uncoordinated nationally-based pricing policies that it stood to lose up to 13% of its profits in one country and 10,5% in another, if only one of its major customers resorted to pan-European sourcing (Euler/Berqvist 1991). While the need and the urgency of a review of companies' European pricing policy are evident, a systematic appraisal of the structural differences responsible for existing international price differentials has not been performed. This, however, is absolutely necessary as it constitutes the first step towards the formulation of a European price policy (Simon/Wiese 1992). The aim of this analysis is then threefold. First, we propose a framework to systematically analyze European pricing conditions. Second, we discuss empirical results of research undertaken in three industries in six countries based on this framework. And third, the implications for pan-European pricing are shown.

2. Theoretical Framework of the Analysis

Price theory suggests that a profit maximizing international price policy is one in which the price in each market is set according to the respective price elasticities and marginal costs prevailing in each country (Phlips 1989; Simon/Wiese 1992). When market conditions across countries vary substantially, this implies that international price differentiation is the appropriate strategy. Various studies (Diller et al. 1991; Althans 1980; Sorensen/Weichman 1975) accordingly show that price is the marketing instrument which is the least standardized. The viability of international price differentiation, however, is faced with several restrictions (Diller 1991). For one, the markets must be separated and no substantial arbitrage between markets allowed to occur. Secondly, the competitive situation in each market has to allow the implementation of the differentiated price. Thirdly, dynamic aspects such as product life cycle considerations may impose a deviation from the (static) optimal price for a specific country, e.g. in the case of entry or penetration pricing for foreign markets.

In order to determine the future pricing policy for the European market and especially the question, if prices need to be aligned across Europe, the factors responsible for price differentials have to be analyzed (Simon/Kucher 1992; Jain 1989). These factors can be found on three levels: the **macro environment** consisting of economic, social, cultural and legal factors, the **micro environment** which deals with the market situation encountered by pricing and **company-internal factors**. The approach taken here is that of market-determined pricing, so that the focus in the following discussion will be on factors of the micro environment. These factors can be grouped further into four categories which combine to be the market determinants of international pricing:

(1) Differences in the prevailing **price structures** between countries are not only to be explained, but by themselves also influence international price policy, especially the problem of price positioning (Diller 1991). Variations in the average price can cause an identically priced product to be situated in the upper price segment in one country and in the lower price segment in another. Therefore, the choice in international pricing must sometimes be made between standardized retail prices or standardized brand positioning (Meffert 1990). A further aspect of the price structure is found in special offers. These may vary across countries and necessitate an adaption to local conditions.

(2) Differences in the **competitive structure** between countries have to be accounted for when formulating an international price policy. Economic theory, for example, suggests that oligopolistic markets frequently show rigid prices, because of the desire of large firms to avoid price wars and the costs associated with price

changes. In such a setting, a foreign firm may have more price freedom than in a polypolistic market (Piercy 1982). In addition, markets in different countries may be at different stages in the product life cycle. This implies that a different pricing strategy should be applied and that while price may be an ineffective instrument in some areas, it may be the key to success in others (Diller 1991; Piercy 1982).

(3) The country-specific **distribution structure** is another relevant factor. On the one hand, price freedom and above-the-line discounts may differ considerably within similar retail formats, as the result of differences in retailer power (Euler/Lindqvist 1991). On the other hand, the degree of internationalization of retailers strongly affects the ability to differentiate prices since international retail chains may either perform arbitrage or purchase centrally in the country with the lowest price level (Maucher/Brabeck-Lethmathe 1991).

(4) Differences in **consumer behavior** between countries also affect the possibility to standardize pricing. Frequency and intensity of use of certain products often vary internationally with implications, for instance, on package sizes and consequently on unit prices. Other aspects such as differences in brand loyalty and price awareness also require consideration and may influence international pricing both on a strategic level (e.g. price positioning) as well as on a tactical level (e.g. special offers).

3. Pricing Conditions in Selected Industries

The pricing conditions of the detergent, the take-home ice cream and the watch market are analyzed in Germany, France, Italy, Spain, the Netherlands and Belgium. The information was compiled from household and trade panels, industry publications, and from a large number of interviews held in each country with industry experts from consumer goods firms, trade associations, retail organizations and market research companies. Furthermore, an ad-hoc consumer survey was carried out with a total of 181 female heads of households questioned in all countries except Italy. The analysis in Germany is confined to the area of the FRG before reunification.

3.1 Price Structure

The average consumer prices of these industries vary considerably within the EC, with Italy generally displaying the highest price levels. This can be partially explained by a more expensive product range on offer, as in the case of watches, where the average price in Italy is 60% higher than in Germany. The consequence is that a producer who is positioned in the medium-high price segment in Germany has two options for Italy: Either he will have to contend with a lower image in Italy, since raising prices on identical watches does not appear to be suitable, as especially watches are endangered by parallel imports due to their high value to shipping-cost ratio, or he will have to operate with a different program if he seeks to have the same brand image there.

TABLE 1
AVERAGE CONSUMER PRICES: DETERGENTS AND WATCHES
DEVIATION FROM GERMAN AVERAGE PRICE(1991)

	FRA	ITA	ESP	NL	BEL
Powder D.	-7.9%	+33.1%	+2.3%	+5%	-2.6%
Concentrated D.	+5.5%	+35.4%	+12.7%	+17.5%	+18.6%
Liquid D.	-19.8%	+27.5%	+10.6%	+5.6%	-11.8%
Watches	-1%	+60%	-51%	-6%	n.a.

Sources: Nielsen, GfK, Joyas y Joyerias

The market for detergents exemplifies a further dilemma of international product line pricing. The variations of the average price of washing powders and concentrates between countries are such that the average price distance of concentrated to powder detergent is app. 64% in Germany but almost 100% in Belgium. Since detergent producers usually offer all three types of detergents, both a standardized absolute price level as well as equivalent product line pricing are not consistent with the prevailing price structure. The take-home ice cream market is another case of extreme price differences. The absolute price per kilo of high-priced Dutch ice cream, for instance, is less than Italian ice cream in the low-price segment. The price of virtually identical products also differs significantly, with the prices of selected brands in each country basically reflecting the underlying price-structural differences.

TABLE 2
CONSUMER PRICES OF SELECTED TAKE-HOME ICE CREAM
BRANDS: DEVIATION FROM GERMAN PRICE

	FRA	ITA	ESP	NL	BEL
Industry Average	+37%	+86%	+99%	-12%	-3%
Mars	+7%	+24%	+41%	+4%	+32%
Carte d'Or	-7%	+48%	+54%	-16%	+24%
Vienetta	+37%	+98%	+56%	+1%	+31%

Sources: Nielsen and own survey

The analysis of special offer pricing also reveals considerable differences in the EC. Especially the importance and forms of special offers vary significantly. In the Italian detergent market, for example, 80% of sales occur as part of a special offer, however seldomly via a direct price cut, but rather with other special offer methods such as on-packs, special package sizes or coupons. In Germany, however, the direct price reduction is predominant, pimarily due to tighter legal restrictions on special offers (Metzger 1991; Schaltenberg 1988).

TABLE 3 IMPORTANCE AND FORMS OF SPECIAL OFFERS				
	Ratio of special offer sales to total sales volume		% of special offers employing direct price cuts	
	deter-gents	take-home ice cream	deter-gents	take-home ice cream
GER	0.5	n.a.	80%	97.5%
FRA	0.7	0.17	53%	60%
ITA	0.8	n.a.	10%	n.a.
ESP	0.63	0.37	70%	85%
NL	0.28	0.2	57%	27.5%
BEL	0.6	0.18	32%	70%
Sources: Estimates based on expert interviews				

The analysis of the price structure in these industries leads to the following implications for a European price policy: The existing price structure indicates that generally an adaption of pricing to the country-specific situation is to be favored. In various cases, identical brand postioning actually requires either different consumer prices or, if price discrimination is not viable due to the danger of parallel imports, international product range differentiation. The prevailing differences between countries also suggest that local adaption is the more feasible policy for special offers.

3.2 Competitive Structure

TABLE 4 MARKET SHARES (VALUE) 1991 OF TOP 3 INTERNATIONAL DETERGENT PRODUCERS				
	xxx	yyy	zzz	other
GER	28.4%	38.4%	14.8%	18.4%
FRA	36.5%	15.6%	27.5%	21.4%
ITA	40%	24%	15%	21%
ESP	27.8%	17.2%	15.6%	39.4%
NL	26.5%	23.9%	21.3%	28.3%
BEL	46.9%	21.7%	13%	18.4%
Sources: Nielsen, GfK				

The detergent and ice cream industry offer a contrasting example of how differences in the market structure affect international pricing. On the one hand, the same three producers dominate the detergent market in the EC, so that this market is basically triopolistic. As a result, none of these firms can deviate strongly from the price of other firms, as brand loyalty and product differentiation are not sufficient to tolerate large price differentials among them. On the other hand, only one company has achieved a significant presence in all EC-countries in the take-home ice cream market. In Germany, Italy, Belgium and the Netherlands, local firms play an important role. This means that firm "A" has to deal with prime competitors with different backgrounds and competitive advantages. In Germany the main competitor has a strong position in the premium segment, whereas in Belgium the local contender is positioned in the low to medium price segment. The international price policy of firm "A" must therefore take into account these country-specific competitive constellations.

TABLE 5 TAKE-HOME ICE CREAM MARKET SHARES (VALUE) 1991 OF LEADING FIRMS AND RETAILERS' OWN-BRANDS						
Firm	GER	FRA	NL	BEL	ESP (`90)	ITA (`90)
A	35.8%	19.6%	32.3%	18.7%	29.2%	41%
B	-	23%	-	-	15.7%	-
C	-	21.2%	-	-	11.9%	-
D	-	-	16.6%	-	-	-
E	25%	-	-	-	-	-
F	-	-	-	26%	-	-
G	-	-	-	-	-	31&
own-brands	13.2%	18.1%	17.8%	19.5%	4%	5%
others	26.1%	18.1%	33.3%	33.8%	39.2%	23%
Sources: Nielsen, Secodip, Business Spain, obiettivomarca						

The take-home ice cream market also demonstrates the different strategic importance of price as a result of product life cycle differences between countries. The Dutch and Belgium markets are fairly saturated with relatively high per capita consumption (2.7 liters in NL and 3.0 in BEL compared to 2.4 in GER and FRA; 2.1 in ITA and 0.6 in ESP). Growth in the former markets can only be value-driven with an increasing share of premium ice cream. In Spain, however, per capita consumption is extremely low since take-home ice cream until recently was considered more of a luxury product. Only during the last 4 years has it gained more acceptance as a regular dessert and is now undergoing a dynamic growth phase (A.E.F.H. 1991). The high price level, nonetheless, still represents a barrier for consumers to purchase this product. Therefore, an aggressive price policy is needed to further develop this market.

A further important aspect in the take-home ice cream market is the varying strength of retailers' own-brands that generally are positioned in the lower price ranges. The greater the importance of own-brands is, the lower the pricing freedom for producers' brands. One of the main reasons for the high levels of both the average price as well as specific product prices in Spain and Italy lies in the negligible market share of own-brands. The relatively more heterogeneous structure of the take-home ice cream market thus leads to considerably higher price differentials and more potential for price discrimination than the detergent market.

3.3 Distribution Structure

The retail industry in Europe has experienced considerable structural changes during the last decade, but it is still far from displaying an EC-wide homogeneous structure. Concentration levels vary to a great extent between European countries. In the Netherlands, for instance, the top two retailers command more share than the top seven in Italy. The importance of retail organisation types also differs in the EC. The case of watch distribution exemplifies this. In Spain and Italy the share of traditional retailers, i.e. jewellery and watch stores, is significantly larger than in the other countries. Especially in Germany, both modern watch distribution forms, such as hypermarkets and mail order firms, as well as jewellery and watch store chains have gained share at the expense of the traditional sector. These structural differences lead to different degrees of retailer power and price freedom across Europe for the consumer goods industry on the one hand, and varying channel flow and costs on the other.

TABLE 6
CUMULATIVE MARKET SHARES (VALUE) IN %
OF THE TOP 7 RETAILERS 1991
(FAST-MOVING CONSUMER GOODS)

	GER	FRA	ITA	ESP	NL	BEL
TOP 1	13.6	14.6	9	20.6	25.8	14.2
TOP 2	24.5	28.9	12.9	31	42.4	28
TOP 7	51%	68.3	28.3	55.1	79.3	70.1

Sources: Nielsen, GfK, AGB

A further consequence of the variations in retail structure results from the fact that different types of retail organisations demand and require different types of conditions and terms of sale. In addition, country-specific differences exist. In France, for instance, the time allowed for payment is generally the longest among the countries examined here (90 days for ice cream and 60 days for detergents compared to 30 days for both in the Netherlands). Thus, price discrimination via discounts is feasible and in some cases even necessary both between retail formats and between countries.

While the above mentioned factors generally indicate that international price differentiation is the appropriate policy, the single most important factor putting increasing pressure on the consumer goods industry to standardize prices lies in the internationalization of the retail trade. On the one hand, strategic alliances between large retailers, such as the AMS, are exchanging information and coordinating purchasing and marketing activities on a Europe-wide basis. On the other hand, leading retailers are actively expanding their retail chain networks in other countries (George/Diller 1992). These developments are leading to more market transparency and the practice and potential of retailers purchasing centrally for Europe is growing. In addition, the reduction of barriers in the transportation industry within the EC will lead to decreasing shipping costs (Meffert 1990), so that for many products arbitrage will become increasingly feasible. As a result, the consumer goods industry is confronted with enormous pressure to align their price and discount structure across Europe.

3.4 Consumer Behavior

The largest differences within Europe can be found among consumers and their behavior. The universal "Euro-Consumer" does not exist, since consumer preferences are often strongly affected by cultural factors (Maucher/Brabeck-Lethmathe 1991). These differences in consumer behavior frequently affect international pricing decisions indirectly or directly. A comparison of the per capita expenditures, for instance, indicates that both take-home ice cream and detergents are regarded with varying importance in the countries analyzed here. In southern Europe greater value is placed on washing laundry and the washing frequency is higher than in central/northern Europe. The result is that consumers' willingness to pay also varies.

TABLE 7
PER CAPITA EXPENDITURES FOR DETERGENTS AND
TAKE-HOME ICE CREAM: DEVIATION FROM GERMANY
(ADJUSTED FOR PER CAPITA GNP AND PPP'S)

	FRA	NL	BEL	ESP	ITA
Ice Cream	+25.4%	+9.3%	+17.1%	-38.3%	+59.4%
Detergents	+8.3%	-2.4%	0%	+50%	+61.3%

Sources: Calculations based on data from Nielsen, GfK, Secodip, A.E.F.H., Largo Consumo and Institut der deutschen Wirtschaft

Further factors which vary across countries deal with motivational and cognitive aspects of consumer behavior and are reflected in interest in prices and price awareness of consumers (Diller 1991). In the examined product categories, German, Spanish and to a lesser degree also Belgian consumers display comparatively higher price interest and awareness than their French and Dutch counterparts. The direct implication is that special offers should place more emphasis on direct price cuts in the first three countries. Also, where consumers are more price oriented, the price image of brands becomes more important and differentiation from competitors can rely more on the instrument of price.

4. Price-Political Options in the Common Market

The above analysis has shown that a European price policy of consumer goods companies is faced with two, in many ways conflicting situations. On the one hand, the existing differences in price, competitive and distribution structures as well as in consumer behavior are too large to be ignored and imply that it is both necessary and desirable to differentiate pricing internationally. On the other hand, the internationalization of the retail industry and the increasing danger of cross-border arbitrage often prohibit the implementation of differentiated prices in Europe. Furthermore, the lowering of entry barriers in many industries caused by harmonization of EC laws and regulations will lead to increasing competition, and in many cases price competition, so that further downward pressure on prices will occur. As a result, consumer goods companies may find themselves trapped between the Scylla of insufficient attention to country-specific differences and the Charybdis of centrally purchasing retailers and parallel imports. What then are the pricing options for the consumer goods industry in this scenario? The present situation requires a pro-active stance, since non-action may lead to an alignment of prices at the lowest level with a subsequent erosion of profits. The actual focus of an international price strategy will depend on many product-specific factors, e.g. if shipping costs make arbitrage feasible. Nonetheless, two general strategic approaches for Euro-pricing can be applied.

One option is a defensive or stalling approach, in which existing price differentials are rigorously defended, giving up ground only when it cannot be held at reasonable cost. Such an approach may be feasible for products or brands which must be adapted to country-specific needs, where markets are fragmented and intransparent and where competition remains basically local. A variant of this approach lies in the implementation of a European "price corridor" which tries not to prevent arbitrage from occuring, but attempts to minimize its damage potential, and also allows sufficent room for local adaption of prices (Simon/Kucher 1992; Simon/Wiese 1992). The other option is to employ an offensive or preemptive approach which actively seeks to exploit the advantages of pan-European standardized pricing, for instance by ensuing economies-of-scale (Diller 1987) and preempts a market-driven alignment of prices. This approach may be feasible for Euro-brands with identical target groups in Europe, industries with high innovation rates or markets with an oligopolistic European structure. Furthermore, the offensive approach offers the possibility to gain a competitive advantage by actively cooperating with the increasingly important European retail organizations by implementing a Euro-key-account-management (Diller 1992).

Whatever option is taken, pricing in Europe can no longer remain un-coordinated and left to the discretion of country managers. The pricing challenge of the Common Market therefore also implies an organizational challenge, since instituting a coordinated pan-European pricing strategy will severely constrain the prerogatives of country managers, particularly when they are responsible for profit centers (Euler/Bergqvist 1991). The future success of the European firm, however, depends on the acceptance of these challenges and the development of strategies to counter them.

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