

Session 4:

Costing & Pricing

How should I price my product?



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Hello, I'm Dimitris Kloussiadis, export consultant with the International Trade Center of the University of Georgia SBDC.

Welcome to Session 4 of Export-U.. Export-U.com is a series of export mini-courses developed by the International Trade Center of the University of Georgia SBDC in close cooperation with the U.S. Export Assistance Center in Atlanta under their Rural Export Initiative.



In the previous sessions, your efforts were focused on selecting a few target markets. Before proceeding further in the marketing exercise, it is time to pause and go through a costing exercise to see whether you can be competitive in your chosen markets.

In this session we will CLICK

- consider the various cost factors
- identify costs to get the product to the end-user in the overseas market, and
- briefly discuss pricing (a more complete discussion will come later).



Cost to Market

- Base cost in US
- Cost to port of export
- Cost to port of import
- Landed cost (includes customs & duties)
- Cost delivered to overseas warehouse

First,

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develop costs to the port of import...which is all the expenses needed to move the product from your plant to the destination port.

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Then develop the “Landed Cost”, i.e. the cost to the importer to enter the goods through customs at the port of unloading,

Then, estimate the costs the distributor will incur..

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in moving the goods to the warehouse.

Subsequently, we will look at some additional costs that you may incur in executing export operations, for example product modifications, promotional expenses, financing costs, etc. that will impact the actual base cost of your product.

FREIGHT FORWARDER

(A “travel agent” for your goods)

1. Complete product description
2. Type of packaging & no. of pieces
3. Gross & net weight
4. Dimensions

Photo: Departure - MARCHEN Maersk, Lance Cunningham on Flickr

To complete the exercise for each of your top three markets, you will need the services of a “Freight Forwarder” to provide you quotes on container, shipping, insurance and port handling costs.

Think of a “freight forwarder” as

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a travel agent for goods. A freight forwarder is a critical member of your “export team” who will arrange to ship your goods from warehouse to port, and arrange the loading of your goods for air, truck, rail, or ocean passage. You will find them listed in the Yellow Pages under “freight forwarders.” Exercise care in selecting FFs.... You want to work with an experienced forwarder who is familiar with your products and your overseas markets.

For the freight forwarder to provide you the costs you will incur, you will need to provide them the following information:

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A complete description of the product (also ask the FF to confirm the HS code for you)

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The type of packaging and number of pieces, i.e. number of cartons, crates, boxes, etc.

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Gross and net weights (provide both U.S. and metric weights)

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Dimension of Pieces (again, provide both U.S. and Metric measurements)



FREIGHT FORWARDER (contd.)

5. Ports of export & import
6. Method of shipping
7. Value
8. Special instructions from customer

Photo: Farewell Los Angeles. (nz)dave on Flickr

Other information you will need to provide the Freight Forwarder include:

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The name of the port from which you will ship, i.e. Port of Export and the name of the Port of Import

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Method of Shipping, whether by air, truck or rail and whether the freight will be containerized if moving by water (note that if your goods are to be shipped by container, the FF will arrange delivery of container to your plant)

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Value of Shipment (the FF will need that to quote insurance)

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Special Instructions from the customer (we won't have any in our example -- but the real ones probably will!)

Once you have provided the freight forwarder that information, he or she can provide you the information you need to compute your total shipping costs.

Case Study – Freight Forwarder INFO

Product Description:

- ❖ 12,660 sets of brake pads
- ❖ 633 cartons to a 20 foot container
- ❖ 37980 lbs.
(max 38,000 lbs.)



In creating an example, the exporter is a reseller of brake shoes (not a manufacturer)... and for our purpose of determining shipping costs, we will assume for the moment that his U.S. wholesale price is the same as the export price.

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He is selling 12660 sets of brake pads,

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packaged in 633 cartons to a 20 foot container. The total weight..

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...just barely meets the maximum weight capacity of a 20 footer at 37980 lbs.

With the information the freight forwarder provided the exporter, we can now begin our cost calculations.



SHIPPING COSTS*

✦ <u>Price Ex-Works</u>	<u>US\$ 50,640</u>
✦ Inland freight to Miami	682
✦ Port/ terminal handling charges	50
✦ Forwarder fees	175
✦ <u>FOB Miami</u>	<u>US\$ 51,547</u>
(Free on Board)	

* For more information on INCOTERMS view Session 7



Photo: Robin Stevens, rejs@cvmlc.org.uk

As we go through the costing exercise you will be introduced to the “INCOTERMS” for ocean shipment. INCOTERMS are standardized terms used to define the shipping responsibilities and costs for the shipper and the buyer. In our example,

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“Ex-Works” or “Ex-Warehouse” is a quote giving the price to the importer if the goods are picked up at the loading dock of the exporter. In this example, the cost is the “shelf cost” of the parts sold at the usual U.S. Wholesale price of \$4 / set.

These terms are very important aides in defining responsibilities and should be used when quoting. In the Logistics Course, you’ll learn about all the various terms used. The Freight Forwarder determined that the least expensive port of shipment to Brazil would be Miami and provided us the trucking cost to Miami (including container rental) at

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\$682. In addition the exporter will incur

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Port/Terminal handling charges of \$50 and

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The Freight Forwarder’s charges are \$175.
With these costs known, the FOB price of the goods is

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\$51,547. “FOB” means “Free on Board at the Port of Miami” That is: the exporter pays upfront all the costs incurred from his dock through loading on board the ocean vessel.

Since we are interested in knowing the total costs to our destination port (Santos, Brazil)....



MORE SHIPPING COSTS

✦ <u>FOB Miami</u>	<u>US\$ 51,547</u>
(Free on Board)	
✦ Ocean freight	1,000
✦ <u>CFR Santos, Brazil</u>	<u>US\$ 52,547</u>
(Cost & Freight)	
✦ Insurance	233
✦ <u>CIF Santos, Brazil</u>	<u>US\$ 52,780</u>
(Cost, Insurance & Freight)	



Image: Composite by SBDC

We will need to add a charge for ocean freight of \$1,000

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Giving us a CFR Santos, Brazil price of

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\$52,547.

CFR stands for Cost and Freight delivered to the Port of Santos Brazil.

And finally if we add Insurance

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To the costs we arrive at a CIF-Santos Brazil cost of \$ \$52,780.

CIF means Cost, Insurance and Freight, Santos, Brazil, i.e. the quote includes all costs including insurance to deliver the product to port.

You will find that the most commonly used maritime shipping terms are FOB – Named Port of Export and CIF-Named Port of Import. When you receive a request to quote, most likely it will be one of those two terms. With a CIF quote, the importer will be able to calculate the final cost to him or her.

However, since we are interested in arriving at a final cost to your agent or distributor, we need now to know what additional expenses will be borne by the importer. So let's look at the impact of tariff and port handling charges on the buyer's cost.



BUYER COSTS: FOREIGN TARIFFS

✦ Find your HS Code (Session 2)

✦ Find tariff rates:

✦ Export.gov: “Country Specific
Tariff and Tax Information”

✦ Export-U2.com: “Links page”

Once you know your HS Code, you can also call 1-800-USA-TRADE
for help with foreign tariff info. (or e-mail: tic@ita.doc.gov)



Photo: Chilean Currency, by [Campbell] on Flickr

To find the tariff for your product you must first find the

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“harmonized system” number for your product. Return to the Global Market Research section on Export-U.com to the Session labeled “Determine Your HS Code.” That session will guide you click-by-click through the process of finding the appropriate HS Code.

Once you have found the code,

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go to the website shown and scroll down to the section on determining Tariff rates.

Click on “Country Specific Tariff and Tax Information” which will take you to an alphabetic listing of countries.

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BUYER COSTS: FOREIGN TARIFFS IN BRAZIL

- **Industrial Product Tax**
(or IPI federal sales tax) ranges from 5% to 15%,
- **Merchandise Circulation Tax**
(or ICMS – state sales tax) of about 18%
- **Miscellaneous Tax** of about 1%, and a
- **Social Security Tax** of about 10%.

FOREIGN TARIFF RESOURCE: 1-800-USA-TRADE

(Note: Brazilian tariff & tax rates are exceptionally high, complex, and change almost daily!)



Scroll down to Brazil, and the following information will appear.

As you can see, for Brazil the rate is subject to such fluctuation that the instructions are to call 1-800-USA-Trade to obtain the most current rates on your product. Having done so, the rate is 18% on CIF value plus IPI plus ICMS taxes.

Note that the site will also give you the tax rates that the importer will have to pay.

Please also note that for most countries you would be directed to a tariff schedule arranged by HS numbers to find the proper tariff rate.



BUYER COSTS – LANDED COST

CIF SANTOS, BRAZIL US\$ 52,780
(Cost Insurance & Freight)

✦ Tariff	9,500
✦ IPI mfr products tax	3,114
✦ ICMS VAT tax	11,771
✦ PIS and CoFins tax	7,138
✦ Merchant marine tax	250
✦ Warehouse Charge	235
✦ Terminal handling charge	100

Photo: Buzios, by Przemyslaw Biel at Fotopedia

Having determined the tariff and applicable taxes from the Commerce Department and some additional costs from the freight forwarder, we can now return to calculating the “Landed Cost” to the buyer

(Landed Cost is defined differently by different sources, here we mean the cost to buyer after clearance through customs and payment of all port charges, state taxes, etc.)

Beginning now with our CIF – Santos cost of \$52, 780, we will now need to add

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Tariff duties of 9,500

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IPI Manufactured Products Tax of 3,114

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ICMS Value Added Tax of \$11,771

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PIS and CoFins Tax of \$7,138

CLICK

Merchant Marine Tax of \$250

CLICK

Warehouse Charge of \$235

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Terminal Handling Charges of \$100

BUYER COST – DDP

(Delivery Duty Paid)

◆ Custom brokers union fee	160
◆ Custom brokerage fee	343
◆ SISCOMEX fee	30
◆ Cargo transportation fee	35
<u>Landed Cost – Santos, Brazil</u>	<u>\$ 85,456</u>
◆ Inland freight	100
<u>Delivered Duty Paid –Sao Paulo</u>	<u>\$ 85,556</u>

Photo: iStock Images courtesy of MODIS Rapid Response Team at World Bank by Holly Rhebeck

Plus

CLICK

Custom Brokers Union Fee of \$160

CLICK

Custom Brokerage Fee of \$343

CLICK

SISCOMEX Fee of \$30 and

CLICK

Cargo Transportation Fee of \$35

Bringing the “Landed Cost” to US\$ 85,456 on a product that cost “ExWorks” \$50,640.

I will point out that most countries do not have all the “extra” costs that Brazil piles on! In addition, many of the various taxes will be imposed equally on all imports of like product, so you are not at a competitive disadvantage relative to other exporters of your product into Brazil.

Now one last thing to get an idea of the cost of the product delivered to customers door

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Add to the Landed Cost the Inland Freight charge to Sao Paulo of \$100

And we come to a final price delivered duty paid (DDP- Sao Paulo) of \$85, 556.

(By the way, you do not want to use the term Delivered Duty Paid as a sales term - we use it here because we want to see whether the cost will allow you to be competitive)



The Results

Ex Works	US\$ 50,640
Landed Cost – Santos	US\$ 85,456
<u>DIFFERENCE =</u>	<u>US\$ 34,816</u>
Unit Cost Ex Works	US\$ 4.00
Unit Cost Landed	US\$ 6.75



Given the Ex-works cost of

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\$50,640, the total cost “Landed” has risen to

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\$85,456.

Meaning that the unit cost of the product has risen

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from \$4 to \$6.75 – or an increase of almost 70%!

And, the Distributor/Agent has yet to add his mark-up to the cost – which would probably double the Ex Works price!



Repeat the Exercise

For each of your target markets

Check for any additional expenses

Photo: http://frank.itlab.us/photo_essays/wrapper.php?mar_09_2012_sunrise.html

For simplicity's sake in the previous exercise we left out some additional expenses.

But, as you

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duplicate the costing exercise for each of your target markets,

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there may be some additional expenses.....



ADDITIONAL COSTS

- Market product requirements
- Promotional costs
- Financing costs

Photo: Sugarloaf Brazil, by lylan reis, <http://www.fotopedia.com/items/00rv5mqg8md-VF25aGOvz8>

The basic areas where additional costs may need to be added are:

-CLICK-1- market product requirements.

-CLICK-2- Market promotion costs, including agent/distributor support costs. And –
one cost :

-CLICK-3- often overlooked: financing requirements.



PRODUCTION COST FACTORS

- ✦ Product modifications
- ✦ Certifications/ testing
- ✦ Packaging requirements



Photo: Assembly line of the Q400, by EADS/CFE/Embraer

Through your market research, you found that some of your target markets have various entry requirements that will cause you to incur additional expenses in order to “qualify” your product for market entry. These might include:

-CLICK-1- Modifications to the product to meet Safety and/or Industry Standards, for example: changing from 110 volts to 220 volts for many markets in the world.

-CLICK-2- Certifications: Depending on which foreign market you shipping your products to, it may be required that your product should be tested by a specific certifying body in order to meet entry standards. The best known of these is probably ISO9000, which is a quality control certification, and frequently required when selling as an EOM into major European firms.

-CLICK-3- Packaging requirements. For example: the European Union and many other nations have “green” requirements for packaging. In those nations you may not be able to utilize Styrofoam packing materials for example, or perhaps you may have to contribute to a disposal fund for your product, when your product is discarded after use.

More commonly, the purchase order will state that the goods must be “export packed” -- i.e. securely packed to make the long voyage, and if moving by water, the goods will have to be protected from potential water damage or moisture.

But packaging also extends to cultural issues. Certain colors might need to be avoided in some countries (for example: green is the color of death in some African nations, white in others) and certain numbers may be “taboo” in some countries so packaging 3 to a card, etc. may have to avoided in some markets

As your researched markets in the previous sessions, these additional market requirements may have been among the factors that might have influenced your market selection. Whether the cost/benefit ratio is acceptable, will depend largely upon the financial as well as other resources available to you.

One other area in which most companies will incur expense is International Promotion

PROMOTIONAL EXPENSES

(-) US marketing

(+) Foreign marketing:

- trade shows
- translating literature
- overseas travel

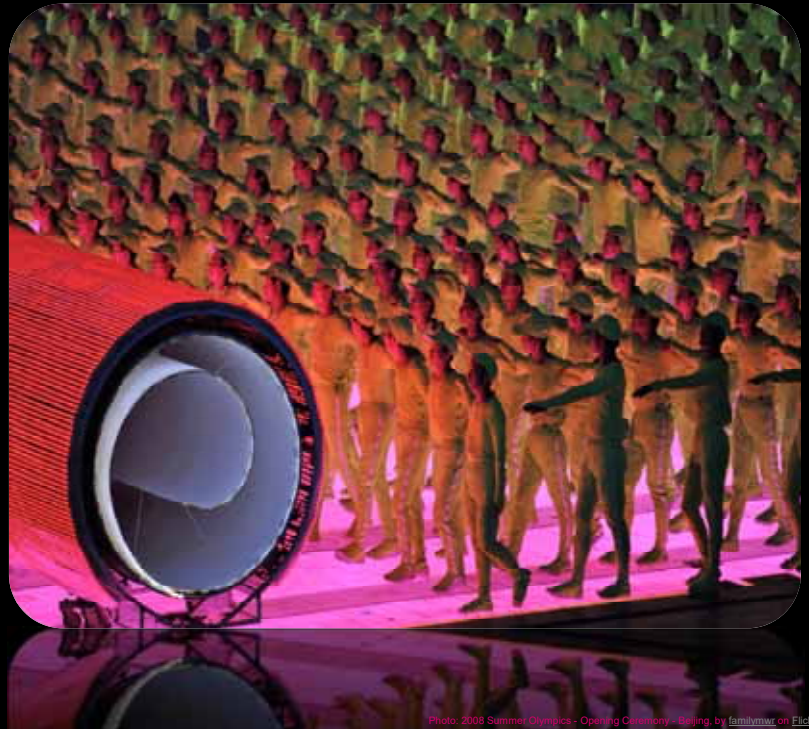


Photo: 2008 Summer Olympics - Opening Ceremony - Beijing, by familymar on Flickr

There is both a Debit and Credit side to costs relating to promotion.

-CLICK-1- Those promotional costs related solely to promoting your product within the home market should be subtracted from the basic unit cost of your product in our opinion. Such promotion is of no benefit to your distributor or agent in an overseas market and he or she should not share in covering those expenses.... On the other hand

-CLICK-2- there are costs that may be incurred in promoting your product overseas. Among those expenses are trade shows, translating literature (both promotional literature and instruction manuals) and overseas travel. The extent to which you are responsible for these costs will depend largely on your agreements with your overseas partners and should be defined when you enter into a representation or other agreement.

What impact does that have on the brake parts reseller for whom we ran the costing exercise? SLIDE

ADJUSTED COSTING EXERCISE

<u>Wholesale Price</u>	<u>US\$ 50,640</u>
Special export packing	127
<u>Marketing Costs:</u>	
(+) Sales staff	---
(+) Advertising	500
(+) Exhibits/ trade shows	---
(+) Discounts/ commissions	227
(-) Domestic marketing	(-1,200)
<u>After Mod. & Promo</u>	<u>US\$ 50,294</u>

If you recall, the basic Ex-works cost we used was the

-CLICK-1-

“wholesale price” domestically. The company is a reseller - not a manufacturer. Therefore, he does not incur any product modification costs as those are borne by his vendors. His primary market is auto part chains within the Caribbean Basin. The firm obtains the product,

-CLICK-2-

repackages and re-labels for the various chains to which he sells. Under his arrangement, the buyer is responsible for the costs associated with private labeling. He promotes his service primarily through the web, through personal contact, and a few select ads in journals so his marketing costs are relatively low....

-CLICK-3-

About \$500 per container sent. And, he does offer promotional discounts and commissions to promote sales about \$227/container. The company also does sell into the domestic market and his expenses related to domestic marketing are higher... About double the international promotion expense at \$1200/container. However, since that expense is directed only at the domestic market, that expense is subtracted from his base cost.

-CLICK-6-

ADJUSTED COSTING EXERCISE

<u>Product w/ Mods & Promo</u>	<u>US\$ 50,294</u>
Financing expenses	227

<u>Ex Works – Atlanta</u>	<u>US\$ 50,521</u>
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<u>DDP - Sao Paulo</u>	<u>US\$ 85,365</u>
(Delivery Duty Paid*)	
Decrease of	US\$ 191

* For more information on INCOTERMS view Session 7

Doing business involves financing... whether covered by internal funds or external funds, i.e. a loan. That cost should be captured in the costing of the sale.

In international, the seller will normally incur fees for various services..... In or outbound wire transfers, letter of credit negotiation fees, etc. These, too, should be part of the cost equation. In our example, the exporter allows

-CLICK-1- \$227 per container to cover financing expenses, bringing the total revised Ex Works cost to

-CLICK-2- \$ 50,521. Since most of the Brazilian taxes are based on the combined CIF price and Tariff, the overall cost to the buyer (Delivered duty paid to his door) will also slightly change.... The new DDP-Sao Paulo cost is now

-CLICK-3- \$85,365 a decrease of \$191.

AGAIN, I want to stress that Brazil's taxes, etc. are more than you will encounter in most counties, and the "compounding" effect on "bottom Line" would not be so profound as in the Brazilian example.



- Don't Know as of yet?
- Compare relative costs of market entry
- Can price properly for the market

That said --- Does the increased cost mean that the exporter cannot be competitive in Brazil?

The costing exercise does not answer that question, so the simple answer is

-CLICK-1- “Don’t Know” Or -- don’t know as of yet... To know whether you can be competitive, further market research is needed to determine what the price points are for the product in this market. We do know that world exports of brake parts to Brazil tripled in the past five years.... So the price may not be a determining factor. ... but the exercise has demonstrated the ability to know, what your entry costs are going to be. And that, has two advantages for you: You can

-CLICK-2- compare the costs of entry into your different markets – and cost of entry will be a key factor in determining your best markets. Secondly, when the time comes to converse with prospects, etc., knowing your costs for each market will

-CLICK-3- allow you to price properly for that market.....



Trade Assistance



call:

1-800-USA TRADE

or consult your nearest:

US Export Assistance Center

In Georgia you can also call the SBDC International Trade Center
at 678-985-6820



-CLICK-1- I wish you the best in your efforts, and if you should have any questions about the topic discussed, please feel free to drop me an email by

-CLICK-2- clicking the button to the left of the screen. Alternatively, you can call

-CLICK-3- the Commerce Department's Trade Information at 1-800-USA-TRADE. You can also contact your nearest

-CLICK-4- US Export Assistance Center, Or Small Business Development Center.

Thank you again.

Session 4:
The End

Costing and Pricing

