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Manufacturer Price Gaps on Notice With Supreme Court Decision

By Aaron Jackson

In March 2013, the US Supreme Court settled the Kirtsaeng v. Wiley case by issuing a reseller favorable ruling, which applies the "first sale doctrine"—a legal notion applicable to copyrighted, patented, and trademarked goods—to items manufactured outside and later imported into the United States. The decision continues the Court's expansionary application of the doctrine within, and now outside the United States. After the ruling, a manufacturer has similar legal grounds, when a distributor ships a product from either Mexico or Nebraska to California. And combined with manufacturers' increasing product-harmonization trends, country level price gaps increasingly provide retailers and distributors diversion opportunities.

Many resellers have long advocated this legal interpretation as it gives them more negotiating power. Manufacturers, historically, carried out country specific pricing through using import-export restrictions and awarding authorized distributors' exclusive sales territories. But with the US dollar's gradual decline during recent years, growing presence of harmonized packaging and cross border retailers, and the recent ruling, manufacturers' pricing flexibility will likely shrink while demands to coordinate customer strategies across borders grow more complex.

Implications for Manufactures

Manufacturers make many considerations when setting a country's price, and as a result, consistent pricing is a rare event. Critical elements considered include consumer affluence, market competition, and category familiarity. One benefit of differentiated pricing is the ability to capture brand value country-by-country. Prohibiting these practices make capturing brand value more difficult and managing customer relationships more challenging.

The Supreme Court ruling means that price strategists must now consider a new strategy element—Foreign and cross-border resellers' import capabilities. Costco has stoked the ire with a few companies because it bought products in a secondary market, and undercut a manufacturer's suggested price when presenting the items for sale. With the ruling change, manufacturers' sales strategies must consider the increased risk that products destined for customers outside the US may, nonetheless, arrive at stores in the United States. Thus, reseller import capabilities become a constraint on market price differences.

Global supply chain efficiencies have increased during the last ten years. Gains have come from various sources including trade barrier reductions and harmonized packaging introductions. Whatever the source, a more efficient supply chain puts pressure on wide price gaps. The recent ruling may challenge some business models, because resellers can now move products into the United States, which could threaten a manufacturer's US profits.

When faced with cross-border reseller demands, manufacturers will probably have discussions around the best alternative for managing the sales relationship. Two structures dominate these discussions:

a) Form an account team with cross border responsibility.

b) Manage the country buying offices separately, but support the sales teams with coordinated strategies. Inevitably, a cross-border reseller will compare price and promotion support across the borders. Coordination among sales teams is inevitable, but the speed at which the manufacturer moves up the priority list, thus demanding detailed coordination depends on many factors.

Which alternative is best, depends on an organization's culture and normal ways of working.

The customer's comparison pits their cross-border supply chain against the manufacturer—similar to many customers analysis of pick up allowances and backhaul opportunities. Understanding logistical nuances will help a sales team survive the potential turbulence.

Identifying Potential Problems

For many manufacturers, market pricing for countries outside the US has been independently managed, and this practice made sense in a world where imports into the United States could be prohibited. Now it is not so. Many cross-border supply chain possibilities exist, and analyzing all is impractical and time consuming. We find three crucial analyses help efficiently assess risk:

Cross Border Pricing

By comparing prices and volumes as a cross-border reseller would (store or warehouse delivered), a manufacturer can identify excessive price gaps or large reseller profit opportunities. Knowing relative competitor gaps and market shares also helps the sales executive estimate the priority ranking of the country pair. Once at risk pairs are identified—those with large profit opportunities—Supply Chain routes can be prioritized for further analysis.

Supply Chain

Supply chain assessments are most difficult to perform when they include unfamiliar routes and activities. However, reviewing the cost assumptions and activities through a structured framework, helps identify information needs and areas warranting additional study. Additionally, the exercise is valuable because it identifies reseller choices and improves the Sales Force's preparation for customer negotiations. The analyst must answer, "how large a price gap is practical?" Using both the pricing and Supply Chain analysis results, high-risk country pairs will be better segmented.

Market Structure

High-risk country pairs should be analyzed for influential cross-border customers, and trade patterns between businesses. At this point, local knowledge becomes imperative in the customer risk assessment and market pair prioritization. Competitive strength, profit opportunity size, and manufacturer strategy objectives can be used with game theory to help develop corrective strategies that support a manufacturer's objectives. As conditions warrant, pricing strategy refinement can begin with a focus on priority markets before cross-border resellers seek advantages from uncoordinated prices.

As individual resellers raise price consistency questions, manufacturers should go through the previously discussed procedures, but focused on the reseller's supply chain options. When considering pricing strategy, customer level implementation concerns can become murky and clouded due to the inherent resistance to change in well-established sales relationships. Preparing for the future with a pricing strategy based on clear policies and principles is a wise step forward, because it eases implementation once a manufacturer better understands the feasibility and leveragability of the customer's options.

About The Author: Aaron Jackson has extensive experience with Route-to-Market projects and strategic analysis across a wide range of CPG/FMCG categories. His corporate career at Mars, Inc. provided a diversified background across the Sales, IT, Purchasing and Corporate Staff functions, as well as international experience. Aaron has a BBA from Howard University, an MBA from Stanford University and is a Certified Public Accountant.