

Price Strategy for Small Manufacturers in Japan

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Preface

I have presented so far the reality and secrets of marketing strategies practiced by successful small manufacturers in Japan especially from the viewpoint of product strategy and promotion strategy in the series of preceding “Shokei Rosou” of Kyushu Sangyo University. There, the definition of small manufacturers made by the Fundamental Law of Small Businesses in Japan and the important roles they play in the Japanese economy are also already presented.

In this paper I would like to clarify the reality and secrets of their marketing strategy from the viewpoint of price strategy.

Before starting discussion I would like to make it clear again that “small manufacturers” referred here and so far are all independent manufacturers of small size. In other words, they do not include “Shitauke Companies”, which are small manufacturers subordinately affiliated to large enterprises without freedom of carrying out marketing strategy of their own free will.

Section 1 Outline of Price Strategy

1 Significance of Price Strategy

It is when the customer has judged the satisfaction he can gain by the purchase and use of a specific product to be equivalent to or larger than the price, that he decides to purchase it. Sometimes he purchases it because he has judged its quality or performance to be as high as or higher than its high price.

Moreover, the price is not only the factor to decide the amount of profit brought to an enterprise but it could be the means of sales promotion. Yet, it will

be impossible to set an exactly salable price unless the prices of the competitors are taken into account. Accordingly, the price must be set properly after studying the customers' evaluation, the product property and the competitive relationship.

The price strategy, thus, means to “set the price of the product or service appropriately for the purpose of increasing demand and making long-term maximization of profit; developing the business competition to your advantage.”

2 How to Develop a Price Strategy

As pointed out in the preceding “Shokei Ronso, since the price strategy is one factor of the marketing mix, it should be based on an enterprise's comprehensive marketing strategy, and planned properly in coordination with the other “mix” factors, above all, the product property, so as to adequately match the requirements of the market environment (especially the trend of target customers and competitors).

In other words, first of all, a basic policy should be established regarding the price line, discount, time of price change, etc. in order to fit the concept of product(i.e.a range of product properties concerning the marketability and social requirements)with the ingenuity of giving 120% CS to target customers and enough profit to the enterprise. When planning a price tactic, which is temporary or based on a local price setting, change or stabilization, it is important to cling to the basic attitude of planning and executing this on the basis of the overall price strategy.

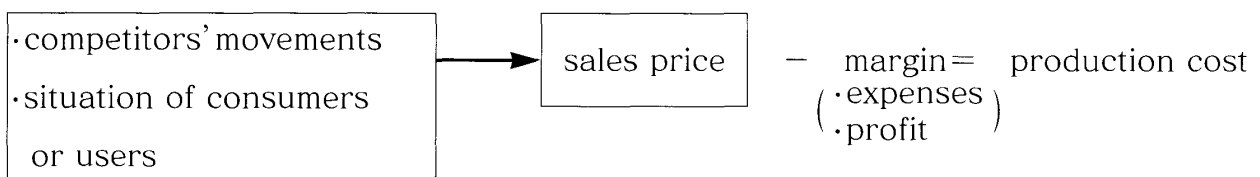
To put it another way, the strategic pricing system should be used instead of a mere cost-plus system. The cost-plus system is easy to use, and if sales are made at the set price, a certain margin can certainly be gained, but there is no guarantee of sale at that price. Except for monopolistic enterprises, it would be accidental if sales were achieved just by adding a certain level of margin to the cost without considering the customers' desired prices and the competitors' prices in this modern era of free and severe competition, and under depression.

In order to establish an “overwhelming competitive advantage,” one of the targets of this book, the price should also be attractive for customers. In case the

product itself has sufficient competitive advantage, if the price is attractive in addition to that, the overall competitive advantage will be overwhelming. It would require considerable managerial effort to realize an attractive price, but in this case, at least, the folly of setting a price which dampens the purchasing desire should be avoided. For that, it is essential to make price-setting by using the strategic pricing system.

Strategic Pricing System

actual market conditions



Under this system, first, the “salable” price is set, then great effort is made to curtail the production cost to gain a certain amount of margin for that price.

In other words, the most salable price is set after realizing the product quality and performance, brand power, customer satisfaction, prices of competitors' goods and substitute goods, the price of the price leader, consumers and users' evaluation of the price, the budget of target customers, the target customers' psychology for the price¹⁾, and considering the positioning of the particular product in the particular market. Then the work begins to adjust the cost(both variable cost and fixed cost)to gain a certain margin for that price. It is also required to estimate the level of sales needed to attain the necessary margin under the given production cost²⁾.

Small manufacturers, limited in managerial resources and fundamentally lacking in competitive power, should adopt this strategic pricing system in order to cope with competition and take advantage of their own strengths.

Section 2 Price Competition and Non-Price Competition

1 Price Competition

(1) Significance of Price Competition

This is a competitive mode of increasing the sales by stimulating demand through a price cut as a means of marketing competition.

As seen in Figure 1, this is the policy of moving the sales quantity from q to q_1 by lowering the price from p to p_1 , resulting in expansion of sales volume from $p \times q$ to $p_1 \times q_1$ on the demand curve D of the relevant product.

There are two kinds of price competition; the so-called price-cut battle seen in both the competition period and maturity period of the product life cycle and the penetration pricing policy (a scheme to market the product at a low price from the beginning), established when introducing a new product or new business.

Since small manufacturers can hardly reach the production scale required, it is often disadvantageous for them to be involved in price competition. This is truer of manufacturers which need equipment investment. There are a few cases in which a small business within the wholesale, retail or service industry has established an overwhelming competitive advantage by realizing a low price through an all-out cost efficiency improvement policy as well as the radical single segment concentration strategy.

There is also a case whereby successful small manufacturers in the niche market could take the cost leadership strategy³⁾ proposed by M. E. Porter, because of the scale merit they could gain in the particular industry. They made the price cut to dampen the desire of a possible competitor entering the market, thus making their overwhelming market share unshakable.

One example is Japan Medical Products, a “Vital Small Company” of non-woven products for medical use with overwhelming market share (presumably 65% in the field of medical non-woven masks)⁴⁾

This corporation denies the “sink or swim” style of management which relies on large margins and has the motto of setting a marketable price without seeking immediate profit. In addition, in order not to allow its established market to be taken over by its competitor, it always pictures its imaginary rival for the analysis of what quality and price to establish to enable it to enter the market. As a result, the manufacturer forestalls the assumed rival with the strategy of lowering the price to below the possible marketable price of the latter, thereby maintaining

overwhelming market share.

Another example is Daito Press Industry, a “Vital Small Company” of rear mirrors for buses with presumed market share of 90%⁵⁾. It has kept the price as low as possible by lowering the profit as well as production cost through reexamination of design and production process and also through replacing the workers with part-time workers. As a result, the company has been successful enough in establishing a barrier for competitors to enter the market.

(2) Means of Price Cut

For the purpose of expanding market share, a low price sale with reduced gross profit is conducted at times. This is a temporary scheme, in many cases, however. After a certain level of share is secured, the price is gradually raised back near the

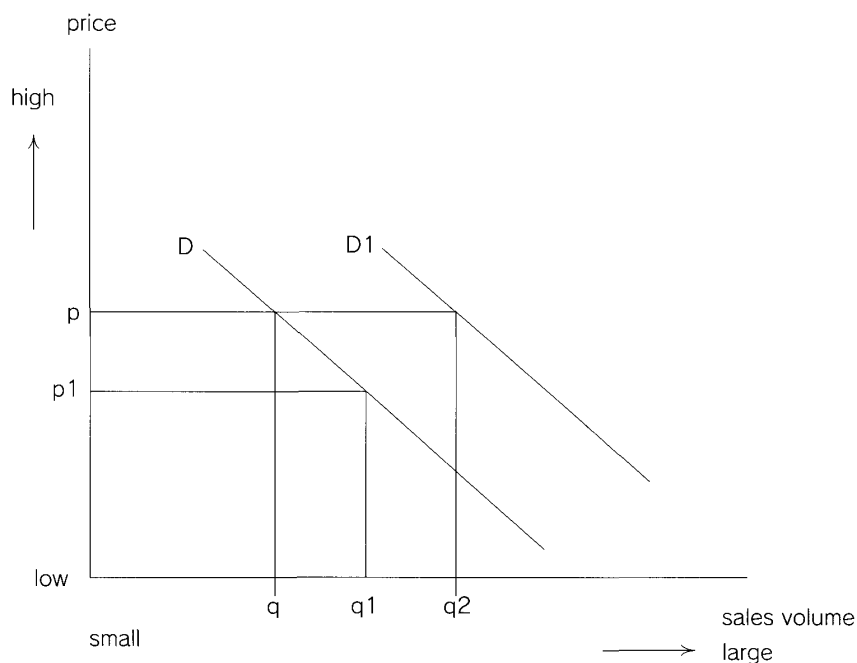


Figure 1 Price Competition and Non-Price Competition

original level.

In case an enterprise is forced to keep the low price for the long term for such structural reasons as yen appreciation, the catch-up of developing nations, the growing possibility of participation in competition by enterprises not only in Japan but in other advanced industrial countries, and the prevalence of the

consumers' price-orientation demand, it must make a drastic reduction in cost and expenses to gain a certain profit for that price. Keeping costs down by an enterprise is critical to support not only price cuts but also the maintenance and improvement of the pay level required for maintenance and enhancement of employees' morale and the maximization of the long-term profit required for the survival and development of the enterprise.

The following are major ways small manufacturers can reduce costs and expenses.

① Factory transfer or production consignment to a country with lower labor expenses and rent

② Purchase of materials from abroad

“Endo-Shokuhin,” a maker of “gari” (sliced pickled ginger for sushi) for sushi shops, imports 70% all material ginger, realizing the ratio of material purchasing cost at the level of 50%⁴⁾.

③ Improvement of production facilities

Matsuura Sangyo, a “Vital Small Company” of handles for shopping bags, developed and installed a highly efficient ideal production facility for the handles, which was twice as efficient as the competitors' ordinary facilities. Accordingly, the company could lower the price from 4.3 yen a piece to 3.6yen a piece, which helped the company to become the top share company⁶⁾.

④ Automatization of design and production

⑤ Rise in the ratio of part-times

⑥ Removal of the waste of other expenses

⑦ Making the parts common and entrusting the set-up work to outside companies

At the time when it was a common practice for craftsmen to process metal one by one, “A and D,”⁷⁾ a “Vital Small Company” of high precision electronic scales, succeeded in significantly lowering cost by introducing a metal mold to make the parts common as a pioneer of this new practice in the industry, and by entrusting the assembly to outside factories as much as possible, thus uniting the craftsmanship with the high-precision digital conversion technique.

⑧ Construction of a thorough production system by self-production

When the material cost accounts for a very large portion of the unit cost of the product, a remarkable improvement in productivity can be realized depending on the consolidation of equipment and devices for production management, by promoting independent production. This progress is seen in the case of “Kaihara”⁸⁾, a “Vital Small Company” of denim.

⑨ Reduction of Channel Expenses

Lower price can be realized through reduction of channel expenses, as seen in the case of “Kaneko”⁹⁾ a “Vital Small Company” of crackers for parties.

In the latter half of the 1970's, Taiwan-made crackers made a large-scale charge on the Japanese toy market at half the price of domestic crackers. With the rapid appreciation of the yen and cheap labor in other Asian nations, there was only a slim possibility that Japanese crackers could outperform the Taiwanese ones despite their superiority in technique and design. The company was made to face a severe choice of whether it should give up its business or transfer its production abroad. After much agony, it came up with the idea of “rethinking the method of price-cut.”

At that time, there were wholesalers involved in three stages of distribution, on average, before the retail sale. So the company bravely constructed its own retail network across Japan to make direct sales to toy shops, skipping wholesalers. As a result, it succeeded in reducing the retail price to the point where it was competitive enough with the Taiwanese make.

2 Non-Price Competition

(1) Significance of Non-Price Competition

As shown in Figure 1, this is the policy of achieving sales of $p \times q_2$ by keeping the price at p , or in its vicinity, and moving the demand curve from D to D' , thereby moving the sales quantity from q to q_2 .

Under oligopoly, low price competition may cause mutual price cutting, resulting ultimately in bankruptcy.

It will be advisable to avoid such invasive competition and compete in aspects

other than price for cooperative competition to influence the demand curve itself and attain larger sales while maintaining the price level.

In Japanese industry, non-price competition has been the general practice. Differentiation in the spheres of quality, service, image, etc. has been the main tools of competition. It is apparent that if a small manufacturer should compete with a large enterprise squarely in the market where the latter is dominant, it would not be able to grow because of the strong brand power and low price competitive advantage brought about by the economies of scale of the large enterprise.

Therefore, in order to avoid such a folly, “Vital Small Companies” have built up business domains in niche markets, where large businesses are weak from the beginning. Generally speaking, this strategy taken by small manufacturers may be said to be a type of non-price competition.

However, in case a very large enterprise enters such a market, a small manufacturer should refrain from price competition with this company and devote itself to non-price competition because it will be forced to set a higher price, considering competition, due to this relatively high cost performance.

Meanwhile, if a small manufacturer in a niche market is to beat business competition and secure and maintain its top market share in the industry, it should strive, first, to attain an overwhelming position in the phase of non-price competition. It is also required to make a price reduction as much as possible through the merit of scale arising from the top position and afore-mentioned ingenuity and efforts for keeping costs down. This will help keep the company's position as the top-share enterprise and also secure profit when sales drop.

Meanwhile, a skimming pricing policy (initially a high price is set for the high-income group, then with an increase in market penetration, the production unit cost is gradually lowered through increased production, thereby helping reduce the price, step by step, and accordingly, tapping into the middle-income and low-income groups) may be said to be non-price competition in the first half of the product life and a price competition policy in the second half, seen from the viewpoint of time.

(2) Means of Non-Price Competition

Concrete means for non-price competition are listed as follows:

① Product Differentiation

This is the pursuit of creative, powerful differentiation in the product to give customers greater satisfaction. This is done by meeting the specific needs and wants of the target market better than the competitors' goods concerning the substantial and augmented properties in the spheres of marketability and social aspect as well as the core property of the product.

Concrete options are exhaustively searched within conscientious features of the product, such as unparalleled afterservice, customer-oriented product, all-volume peerless speedy delivery, consumers' health and safety, and environmental preservation.

② Promotion

Be ingenious with the Promotion Mix (advertisement, personal selling and sales promotion) and push it positively.

③ Development of a new market

Cultivation of a new target market. It can be classified into four patterns
Ⓐ geographical cultivation, Ⓑ beyond-sex cultivation, Ⓒ beyond-age cultivation, and Ⓓ cultivation of different use, etc.

④ Consolidation of the marketing channel

Reconstruction of efficient and effective channels such as the special agent network and the agency network.

⑤ Promotion to increase regular customers

To try to increase the ratio of regular customers by enhancing customer satisfaction (CS), giving great service before and after sales, rendering special service through a membership system and introducing the point card system.

⑥ Others

Apart from the above, there are such policies as door to door sales, use of an automatic vending machine system, adjustment of production volume and prohibition of imposing an excessive sales quota on salespersons¹⁰⁾.

Of all these means for non-price competition, what successful small manufacturers

choose to practice is mainly the “product differentiation” . The followings are the good examples. Here I would like to present them in three types; ①the “consequential type” with the inevitably high price due to the high cost of production(yet, giving customers full satisfaction), such as the refrigerator show case, the single article produced by “Oho-Seisakusho”¹¹⁾ the 300 kinds of safes developed by “Eko-Yamada”¹²⁾ to meet the needs of the users, and the high-quality temperature-measurement control sensor usable for artificial satellites and atomic energy devised by “Okazaki-seisakusho,”¹³⁾ ② the “fame type” such as “Tokunaga-koinobori”¹⁴⁾ which daringly set a high price on the strength of product differentiation of a relatively high-grade product, emphasizing further the product differentiation, resulting in an increase of customer satisfaction, and ③ the “rational type” like the tooth-gap brush by “Taihei-Kogyo”¹⁵⁾ which regarded 30 yen as an appropriate price for the item considering 10 yen per day for three days of consumption for one piece, and set that price, creating differentiation in quality and customer service without price competition.

Section 3 Price Differentiation Strategy

The Anti-Monopoly Law prohibits the setting of different prices according to areas and buyers without any due reason. A similar control is being expected by the Robinson & Patman Law(a law concerning the prohibition of monopoly enforced as a revision of the Craton Law in 1936)in the United States¹⁶⁾.

The difference in cost can be justified by a difference in the method of transaction, the volume of transaction, methods of production, sales, transportation, etc., and so forth.

Since setting different prices greatly helps promote sales, increase sales and profit, and speed up payment, the seller executes various forms of price differentiation strategies for due reasons in Japan found opaque by some European and U.S. enterprises. They can be largely classified into ① Discount policy and ② Price differentiation policy.

The following is a brief outline of both policies.

1 Discount Policy

As discount sales, either by percentage or value, go a long way as promotion, it is an accepted practice for most makers and distributors. It is powerful particularly as a means of cultivating new markets, securing regular customers and improving inventory.

The methods of discount practiced in Japan are ① Reduction of a certain value or percentage from the fixed price, ② Increase of the inner or outer contents and ③ Payback.

(1) Concrete Means of Discount Policy

As substantial approaches, there are the following ten measures:

- ① Quantity discount(cumulative & noncumulative)
- ② Cash discount(for cash payment)
- ③ Seasonal discount(by season, day of the week or time period)
- ④ Trade discount(available for medium and small wholesalers regardless of the purchase volume)
- ⑤ Promotional discount(as an incentive to shops)
- ⑥ Share rebate(for a large ratio of the purchase from a certain maker)
- ⑦ Contract execution rebate(for purchases in accordance with the purchase contract)
- ⑧ Early shipment bonus(for purchase earlier than usual)
- ⑨ Simultaneous shipment bonus(for purchases of goods shipped simultaneously)
- ⑩ Sales promotion cooperation bonus(for cooperation in stock clearance)

(2) Notes on Discount

In the execution of the above discount measures, the following points should be emphasized.

- ① Clarification of the conditions of the discount(percentage or value)
- ② Full publicity
- ③ Execution in accordance with the conditions
- ④ Securing gross profit(from a total point of view)

These discount policies are usually carried out under the leadership of large enterprises, which have overwhelming bargaining power, to small enterprises.

For example, large manufacturers implement these policies to subordinate wholesalers and retailers to promote merchants' motivation for selling the particular manufacturer's products. And large wholesalers and retailers force each subordinate small manufacturer carry out these policies for the merchants' profit.

Accordingly, small manufacturers in general have little opportunities for good profit. The major means to get out of this disastrous situation is establishing overwhelming product differentiation and/or direct sale to customers.

2 Differential Price Policy

The differential price policy allows a difference in the selling price, considering the physical distance between the purchaser and the supplier, the purpose of the purchase, the financial conditions of the purchaser, progressive wages for the workers, etc.

(1) Concrete Means of Differential Price Policy

There are the following five measures of this policy:

- 1) Place-based Differential Price
 - ① Locale price system(FOB or ex-farm)
 - ② Uniform price system(uniform price regardless of the distance of transportation; like postage)
 - ③ Basing point pricing system(price-setting considering the distance from the basing point to the destination of delivery)
 - ④ Zone pricing system(price-setting according to zones making up the country)
- 2) Use-based differential price(price gap between, consumption use and business, use)
- 3) Consideration of the financial ability of the purchaser(reduced fees charged for child, student and the elderly)
- 4) Seasonal differential price(night & holiday fees reflecting extra wages)

Of all these policies, " locale price system" and "use-based differential price" .

are concerned with small manufacturers. And again these policies seem to be implemented under the leadership of large scale enterprises to small manufacturers.

Conclusion

Price strategy works effectively for small manufacturers to attain and keep high market share or even top share in the particular niche market. It is fundamentally important that in setting the price, they should adopt Strategic Pricing System. Since small manufacturers lack managerial resources and the production volume is very much limited, which brings about higher UC and higher selling price. Accordingly, it is essential for them to stick to Product Differentiation Policy, as customers allow them to set higher price if the product is sufficiently differentiated through high market segmentation strategy and product differentiation strategy due to excellent accumulated technology in the specific field. In other words, they should make it their fundamental business motto to pursue “high-quality & high-price” policy. And also they should sell their products through as simple marketing channels as possible.

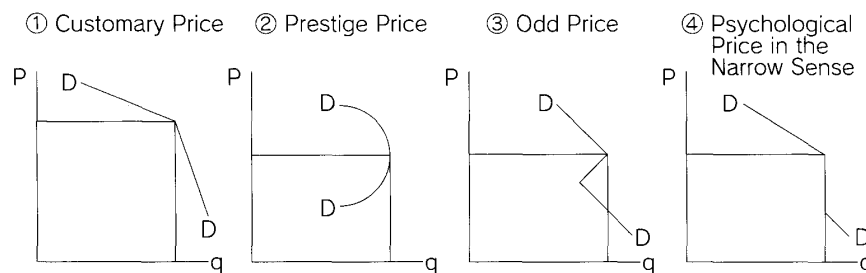
Moreover, looking into the characteristics of marketing strategy carried out by top share small manufacturers or “Vital Small Companies”, it is apparent that once they attain a large share through product differentiation and/or introduction of modern production facilities, they tend to lower the prices to attain top share as well as keeping new competitors away from entering the market, thus they can enjoy remaining in the position of “Vital Small Companies.”

Notes

- 1) There are four approaches for price setting to take advantage of customers' psychology to prices, which are as follows.
 - ① customary price: Prices which customers regard as decent and do not change over a relatively long time. In this case, it is advisable to maintain the price level, as demand decreases when the price is either raised or lowered. The reason is

either the price is contrary to the customers' will or they become suspicious about the quality of the product.

- ② prestige price: When the value of a product cannot be recognized by looking at it, customers tend to judge it by the price. In this case, it is advisable to set the price higher intentionally than its actual value. This type of price is called "prestige price"
- ③ odd price: A price ending in an odd number (such as 57 cents or 63 cents), or a price just under some round number (such as ¥98 instead of ¥100) (P.D. Benett, edited by [1995] p.193) It is found that the latter is more effective in arousing demand.
- ④ psychological price in the narrow sense: a price set at the highest level within a certain range of prices at which the demand remains almost the same.



2) This can be calculated by applying the formula of break-even point, which is as follows.

$$\begin{aligned} \text{necessary sales} &= \frac{\text{fixed cost} + \text{necessary profit}}{1 - \text{variable cost ratio}} \\ &= \frac{\text{fixed cost} + \text{necessary profit}}{1 - \frac{\text{variable cost}}{\text{sales}}} \end{aligned}$$

3) M.E. Porter, *Competitive Advantage*, 1980, translated by M. Toki, M. Nakatsuji and T. Onodera, *Strategy for Competitive Advantage*, Diamond, 1985, pp.34-37.

4) *Nikkei Business* [July 30, 2001] pp.82-83.

5) *Nikkei Business* [April 25-May 2, 2005] pp.78-79.

6) *Nikkei Business* [Dec.6, 2004] pp.74-75.

7) *Nikkei Business* [July 30, 2001] pp.82-83.

8) *Nikkei Business* [Jan.24, 2000] pp.68-69.

- 9) *Nikkei Business* [Oct.16,2000] pp.60-61.
- 10) Japan Marketing Association,edited by,Dobunkan,1995,p.159.
- 11) *Nikkei Business* [Oct.9,2000] pp.72-73.
- 12) *Nikkei Business* [Nov.13,2000] pp.62-63.
- 13) *Nikkei Business* [Jan.22,2001] pp.68-69.
- 14) *Nikkei Business* [April 27,1998] pp.61-62.
- 15) *Nikkei Business* [Dec.11,2000] pp.76-77.
- 16) M.Deushi,*Dictionary of Marketing Management*, Hakuto-Shobo,19 p.263.