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Marketing Strategies

*"The name of the game
in terms of planning during periods of high inflation is
guessing what ways the government is going
to try to correct their bad choices."*
— *Chief executive at Argentine bank*

Marketing under hyperinflation is a continuous balancing act, aimed at overcoming the ravaging effects of soaring inflation rates, while at the same time producing a product with a supportable price. Yesterday's profit-leader can become an instantaneous loser if all aspects of the marketing operation do not adequately compensate for rapidly increasing costs.

Pricing policies undergo a dramatic transformation during hyperinflation. Fluid pricing becomes an absolute necessity, and prices must change frequently and sharply to accurately reflect the impact of inflation. True costs become increasingly difficult to track, even as the need to do so grows more important.

The level of government regulation routinely increases as inflation rises, and anticipation of policy changes — as well as immediate reaction to them — becomes critical.

Hyperinflation creates a growing need for information of all kinds, not only the plans and policies of suppliers, competitors and the government, but even information regarding the current status of black markets, which often arise as a result of the market restrictions that tend to increase during hyperinflation.

The viability of various product lines is greatly affected when inflation rates take off, and those which sell slowly, have low profit margins, or have tightly controlled prices often disappear altogether.

Hyperinflation changes the time frame within which the marketing function must operate. Long-term becomes short-term, short-term becomes tomorrow, and the type of planning familiar to American business people becomes an effort in futility. In the ever-changing world of hyperinflation, prices, supplies, markets and government policies shift continually, presenting the corporate planner with a target that simply moves too quickly and unpredictably for accurate forecasting beyond a period of days, weeks, or, at most, months.

■ ***Be prepared to execute prompt, selective price increases. It may even become necessary to do this on a daily or weekly basis.***

There is widespread agreement among South American executives that timely price changes are probably one of the most important methods for surviving high inflation. For them, however, effective pricing means weaving through a seemingly endless maze of regulations and restrictions. American business managers may one day be faced with similar complications in establishing their own pricing policies. Remember, the United States did have wage and price controls in 1971. (See Appendix.)

Throughout South America, prices often change before the ink in which they are recorded dries. At Bolivia's 50,000 percent inflationary peak, prices had to be adjusted hourly. (Exhibit 7 shows the incredible impact of hyperinflation on the cost of goods.) Customers commonly were quoted prices over the phone when ordering a part, understanding full well that by the time the part was picked up, the price would almost certainly be higher.

■ ***Develop inflation-sensitive pricing policies.***

Pricing goods in a hyperinflationary environment is an extremely complex task. Some of the factors that companies must consider in structuring their prices are:

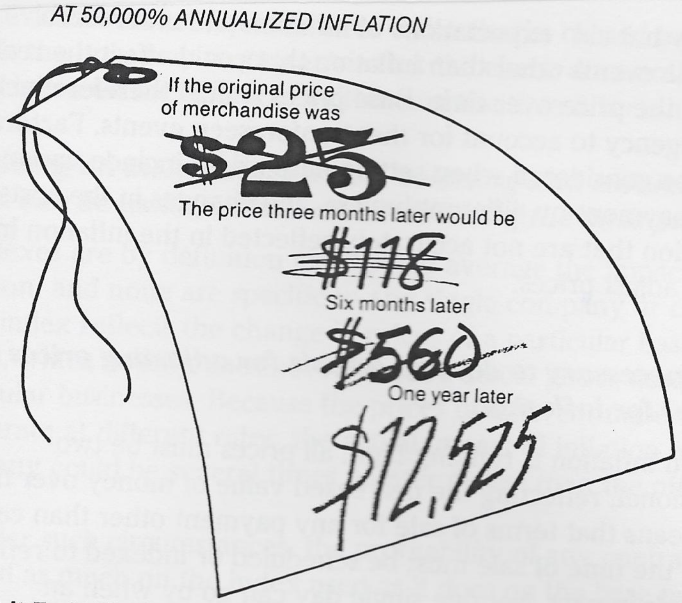


Exhibit 7: *At 50,000 percent inflation, the price on a necktie that cost $25 would rise to over $12,000 just one year later.*

- The appropriate costs to use as a base line for adjusting bills of materials to inflation.
- The future value of the currency.
- The cost of money.
- The best possible forecasts as to future costs of raw materials, parts, labor, utilities and transportation.
- The most reliable available indexes to forecast the industry and overall inflation rates.
- The opportunity costs of the capital used in the production process.
- Inflation adjustments for projects with long lead times.
- Monitoring of actions taken by competitors to reduce costs and therefore keep prices in check.

Should inflation begin to climb in the United States, it will be imperative that American companies adopt measures to factor these considerations into their pricing policies, so they are able to calculate prices that adequately reflect the true impact of inflation.

■ *It is necessary to establish a satisfactory current base price.*

The base price should not only reflect the current state of the economy but also expectations of inflation and unforeseen economic events other than inflation that could affect the real value of the price over time. Base prices should therefore include a contingency to account for these unforeseen events. Factors that should be considered when setting base prices include variance in rate of payment by different buyers, and changes in the costs of production that are not accurately reflected in the inflation index used to adjust prices.

■ *It is necessary to develop a basis for adjusting prices to account for inflation.*

When inflation is running high, all prices must be two-dimensional, reflecting the decreased value of money over time. This means that terms of sale for any payment other than cash paid at the time of sale must be scheduled or indexed to reflect inflation's impact. Not one single day can go by when an outstanding balance does not reflect inflation.

If it is necessary to issue a published price list, it will be imperative that the list be much more detailed than is currently the custom in the United States. Payment schedules may even have to include day-to-day increases, and in any case will have to be updated frequently to account for changes in inflation.

Rather than scheduling of prices, indexation is the norm in hyperinflationary economies, and a way of life in South America. In Brazil, in fact, it has been completely integrated into the economy. The universally accepted index there is a "monetary correction index" called OTN. Technically, the OTN is the interest rate on government bonds, which is fixed by the government on the first day of each month and is based on the inflation incurred during the past month. Prices are stated as "in OTNs," which means that the price is tied to the OTN index. The OTN reflects a combination of inflationary expectations and risk, and helps industry cope with the effects of inflation. Unfortunately, it also feeds inflation by transmitting past inflation rates to current rates of inflation.

In Brazil, a contract for payment "based on OTNs" means that, if a month lapses between the time a contract is signed and payment is received, the seller consults the OTN chart to see the percentage by which the price should increase to account for inflation. The payment price would then be raised by this percentage.

Individuals and companies even write checks "based on OTNs." This is the only way to guarantee that the check does not lose its value between the time it is written and the time it is cashed.

■ *If using an inflationary index, selecting and enforcing that index can be as important as establishing the base price.*

Indexes are by definition attempts to average the impact of inflation, and none are specific to any single company or contract. Each index reflects the change in prices of a particular basket of goods, which usually does not reflect the actual goods used by particular businesses. Because the prices of different materials accelerate at different rates, the actual impact of inflation on any company could be several times greater or less than the official index.

Under such circumstances, the profitability of any contract can depend as much on the index used as it does on the base price, and specialists exist to develop indexes for specific contracts. Use of an index that underestimates the seller's actual rate of inflation can easily turn a profitable deal into a loser.

South American companies have a variety of indexes to choose from. In Brazil, for example, there is the OTN; other indexes tied to the overall inflation rate, to the inflation rate of a particular raw material or group of products, or to the U.S. dollar exchange rate; and still others issued by the unions.

In spite of the variety of indexes, none is a perfect cure-all. Each index benefits certain companies — and certain contracts — more or less than others, so much so that companies are sometimes willing to give a 5 to 10 percent discount in exchange for being permitted to use the index they believe is most advantageous to a particular contract.

In the event of an inflationary upturn, American companies should be prepared to monitor their own specific inflation rates, to ensure that their contracts — if indexed — use an index that most accurately reflects those rates.

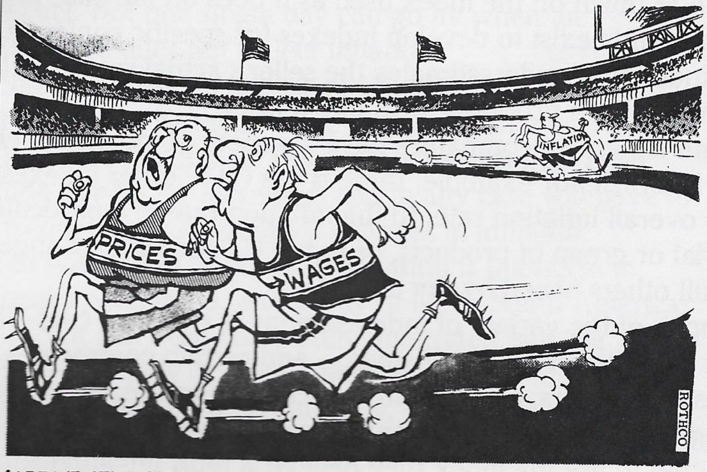
■ *Be prepared to react to wage and price controls.*

Wage and price controls are the almost universal reaction of governments facing runaway inflation. Italy, France and Britain all enacted controls in the years following World War II, and Brazil, Bolivia and Argentina have done so on a regular basis throughout the 1970s and '80s.

The United States instituted controls as recently as 1971, and American companies would be wise to anticipate their impact by reviewing the wage and price policies introduced by the federal government during that period. (See Appendix.)

South American companies have discovered that, during periods when they are subject to price controls, they fight a continuous battle with the government to have their prices adjusted as rapidly as possible to reflect the inflation that is taking place.

One strategy is to submit the highest supportable price in the hope it will be approved. One reason this is important is because South American governments tend to grant price increases based on the official inflation rate, which is often significantly below the actual cost increases the firm is experiencing.



'ARE WE STILL CATCHING UP WITH HIM OR IS HE CATCHING UP WITH US?'

Obtaining approval for a high price is also important because it becomes the base line for future price increases and for the discounts companies offer their favorite customers.

Once the price increase is approved by the government, the item is repriced and immediately submitted for another increase. This frequent changing of prices makes the use of a published price list very difficult, even for a short period of time. Prices are therefore more typically quoted by phone.

One Brazilian manufacturer indicated that during 1986 his company submitted two or three price increases. In 1987 it submitted one per month, and in 1988, due to spiraling inflation, submissions were up to two or three per month.

Under such circumstances, it becomes especially important that companies fully understand and document all of the elements of their own costs. This documentation is necessary evidence to substantiate requests for price increases, and without it, companies may have additional difficulty recouping their costs.

Preparing and filing requests becomes a constant way of life, since it often takes 30 to 40 days for approval. The procedure is so complicated and filled with so much bureaucratic wrangling that companies hire professional price consultants, who are actually lobbyists, to submit and argue the requests. These price consultants wield a great deal of power in this regulated environment.

■ *Large companies and multinationals should expect that their prices will be more closely regulated.*

The impact of price controls varies widely depending on company size, the type of product it produces, and whether it is a national or multinational firm. Larger companies tend to be subject to price controls, while many smaller companies operate virtually regulation-free. (This is not unlike the U.S. experience with wage and price controls in the early 1970s.) In Argentina, small firms tend to get their increases even when they are controlled, while large firms are often used to set examples.

Politics frequently play a role in the implementation of price increases. For example, in Brazil price increases on such consumer items as beer are very unpopular, so their implementation is often delayed until a period when demand falls off, such as just after Carnival.

Regardless of whether or not the government allows a particular price increase, the ability of a firm to charge higher prices is also a direct function of the amount of local and international competition it faces. Firms subject to stiff international competition are more limited in their ability to charge higher prices than those that are protected by trade laws.

■ *Be prepared for the possibility that competitors will sidestep price controls.*

Throughout Bolivia, Brazil and Argentina, circumvention of price controls is widespread. For example, until a recent regulatory change, many Argentine companies made slight modifications to or redesigned their products and then raised the prices, since new products were not governed by controls.

Another common way to circumvent controls is to turn new equipment into used. Because used equipment is not subject to controls in Brazil, one heavy machinery distributor routinely leases tractors to prospective buyers for a month or two, or uses them in his own yard, sometimes only to move dirt from one end of the yard to the other. He then sells the machines as used, often at twice the price he would be allowed to charge for new equipment.

■ ***Be prepared for the appearance of black markets, and factor both official and black market exchange rates when establishing payment schedules.***

History has shown that market restrictions — a typical government reaction to inflation — almost inevitably lead to the creation of black markets, and Brazil, Bolivia and Argentina are no exceptions.

In the hyperinflationary economies of these South American countries, the black market rate often gives a more realistic basis for price adjustments than does the official rate. For this reason, monitoring the black market can become an important aspect of business management during periods of high inflation. Failure to consider black market rates when setting payment schedules can result in prices that fall far short of covering actual costs.

In 1985, when inflation was approaching 50,000 percent annualized, the black market rate in Bolivia changed as many as 50 times a day, yielding 50 price changes per day. Under such circumstances, failure to rapidly adjust prices could easily wipe out any profit margin.

The United States may never experience that order of economic instability, but if inflation rises, market restrictions and the subsequent appearance of black markets are likely results. Under those circumstances, businesses will have to monitor black market exchange rates in order to establish pricing structures that adequately protect profit margins.

■ ***Dependable information on how competitors are adjusting their prices will become increasingly crucial.***

Though it is critical to adjust your own prices rapidly, if you do so more quickly than your competitors, you may lose market share. In high inflationary periods, when prices fluctuate rapidly, it becomes particularly difficult to track prices, yet failure to carefully monitor the prices of your competition can lead to costly pricing errors.

However, in certain cases where the competition's prices are insupportably low, it may be in a company's best interest to sacrifice some market share in order to maintain the proper cost/price relationship.

■ *Develop effective methods to keep track of the actual cost of production.*

South American companies have had to use extensive analyses and sources of information to properly price their products. This is especially difficult to do under severe inflation because it is easy to lose track of changing costs. Proper pricing requires that a company monitor its own internal inflation to accurately determine its actual cost of production.

The difficulty of monitoring true costs is multiplied in high inflationary economies, because all prices do not move at a uniform rate. Averaging costs is therefore useless, because the component costs of some products may increase 100 percent during the same period in which others climb 1,000 percent.

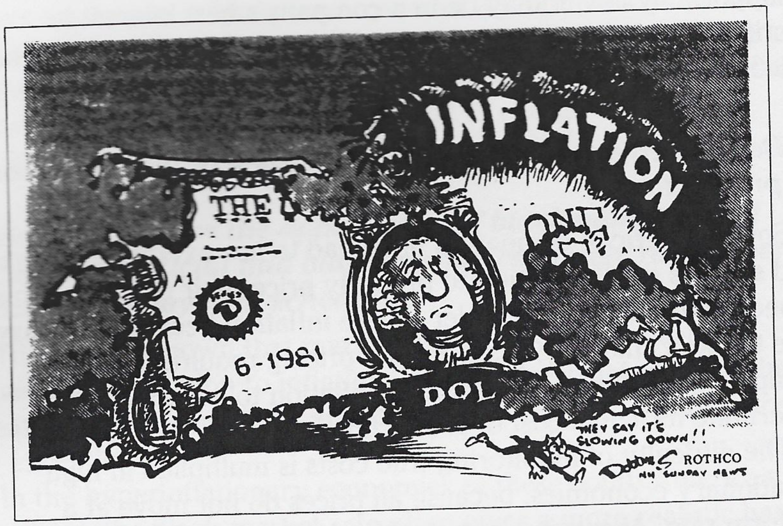
■ *Establish a base period from which to judge inflationary impact.*

It is necessary to have a benchmark to use in measuring the inflationary impact on costs, prices and inventory valuation. This benchmark gives companies the ability to track their own internal rate of inflation, and provides them with data that can be used to justify price increases during periods when price controls are in effect.

To set a reliable benchmark, it would be best to establish this base around a period when inflation was relatively steady.

■ *Prepare to monitor changes in the value of currency with increased vigilance.*

During periods of high inflation there will be frequent and major changes in currency values. Shifting currency values can have a major impact on a company's ability to sell products in foreign markets, altering the relative price of those products in relation to competing products originating in other countries. American companies will need to develop a policy for reacting to these changes, either holding prices down to maintain market share or adjusting them upward to compensate for currency depreciation.



When currency values are unstable, it can also have a great effect on the prices of imported parts or components necessary for production. A flight out of the dollar — a likely result of climbing inflation rates — will have an especially harsh impact on those American businesses most reliant on imported parts.

■ *Choose products with the largest profit margins.*

Rapid changes in the inflation rate, compounded by government policies commonly instituted to fight inflation, can erase the margin on many products in a very short period of time.

In a hyperinflationary economy, the overall philosophy when determining which items should be produced and brought to the marketplace is that they should yield the largest gross profit. High-volume, low-margin items currently produced in the United States would most likely not be produced under hyperinflation. Because government-regulated price increases often do not cover cost increases, the risk of the margin disappearing overnight is just too great.

In Argentina and Brazil, many company presidents have established a minimum acceptable gross profit of 45 percent for any product. The size of the margin is necessary because interest costs on debt are extraordinarily high, and because companies must protect themselves from such factors as: future inflation; government-imposed price freezes that coincide with the skyrocketing of their own costs; rising supplier prices; and pressure imposed by customers to maintain current prices over time.

A fact of life in a hyperinflationary economy is the disappearance of products whose controlled price does not cover the cost of production. In Brazil, for example, dairy products such as milk, eggs and cheese became unavailable when the regulated price was set below their production cost.

Likewise, in the United States, high-volume products with extensive competition — characteristic of many consumer products — may be the first to disappear should inflation begin to rise, because they tend to have low profit margins.

■ *Be prepared to move from long-term contracts to short-term contracts.*

During high inflation, short-term contracts should be used whenever possible, and any intermediate or long-term contracts will have to be amended to include clauses allowing for inflationary adjustments.

Long-term contracts as they exist in the United States are rare in countries experiencing hyperinflation. In the few cases where long-term contracts are issued, specific language is included linking all costs to an index of some sort. Another alternative used in South America is to express the contract in U.S. dollars, a technique that obviously will not be helpful to American businesses.

No company sells on long-term fixed-price contracts in hyperinflationary economies. Any time a capital goods project has a long production horizon, a sizable down payment is required and an inflationary index is used to determine the value of the remaining balance. After a project is undertaken, the indexes are reviewed, negotiated and adjusted to reflect inflationary trends in the economy.

Should indexation become widespread in the United States, it is likely that new indexes will be developed because, among those that are currently most common, the consumer price index is unsuitable for manufacturers, and the GNP deflator's usefulness for specific industry price changes is limited.

■ ***Sophisticated management information systems will be critical for responding to hyperinflation.***

Information is perhaps the most crucial ingredient in strategies for surviving hyperinflation, and it is especially important in the area of pricing. South American businesses often suffer because they are largely deficient in management information and are not widely computerized. Likewise, those American firms lacking sophisticated computerization will be at a major disadvantage, because in a rapidly changing world, those firms prepared to process and react to information the quickest fare the best.

At Bolivia's 1985 inflationary peak, one construction equipment firm had as many as 50 people in the field gathering up-to-date information on the current black market dollar-to-peso exchange rate. A central office was established, complete with a computer installation, and software was developed that could factor a variable price for hundreds of items.

The field people were in constant communication with those in the head office, advising them within minutes of any changes in the black market rate. On receipt of this information, the computer people adjusted their pricing data and new prices were established immediately.

If inflation does take off here, it will become necessary for American firms to develop or reprogram data management systems to analyze data and provide the up-to-the-minute information needed to respond to inflationary developments.

■ ***Make planning a daily or weekly practice.***

In hyperinflationary economies, no company can afford the luxury of annual planning. The ability to forecast and perform forward planning becomes an effort in futility, because in one day's time, every variable in the forecast is capable of undergoing significant change.

Most companies operating in the hyperinflationary economies of South America consider a short-term forecast to be one week, and a long-term forecast three weeks.

According to an importer of plastic finished products in Bolivia, forecasting as little as one month in the future is impossible. "You'd be better off using your own crystal ball," he said.

A top executive of an Argentine multinational company says his superiors in the United States require a monthly forecast, but he knows it is obsolete the moment he puts it in the mail.

Planning becomes instead an almost daily activity. "The way we plan," says a top Brazilian businessman, "is to buy a newspaper in the morning, read the financial and political news, think about it while going to work, and then implement the plan as soon as we get to the office."

This is not to say the planning process is to be ignored, only that it is problematic.

Virtually every economic forecast in every country in the world is based on government projections. In Argentina, Brazil and Bolivia, though, government data and forecasts during times of hyperinflation have proven to be little more than guesswork. Often, the government changes the elements of its data, sometimes excluding an item from the basket of goods composing its inflation index if its price is extraordinarily high for a given month.

According to the president of a small Argentine company, the government's inflation forecasts are usually off by more than 50 percent, and indeed, the 1986 forecast of 28 percent ended up being far shy of the actual rate of 82 percent.

"The economists are generally right in their predictions but generally a good deal out in their dates."

— Sidney Webb, 1924

Under these conditions, most executives try to make their own best guesses as to future inflation rates, which is extremely difficult. During January 1988, for example, inflationary projections for the Brazilian economy ranged between 400 and 1,000 percent annually.

Should inflation begin to soar in the United States, American executives should be prepared to shorten the scope of their planning activities as well. Because of the instability and pace of change that prevail during inflationary periods, projections beyond a few weeks or months can easily prove meaningless, and the long-range planning policies now in widespread use will become virtually useless.

■ *Prepare to communicate verbally with all key operation managers on a daily basis.*

Because of the continuing, rapid pace of change in hyperinflationary economies, managers must be prepared to react instantly to both problems and opportunities. Knowledge and flexibility are critical, as well as the authority to act quickly without having to consult with superiors or deal with red tape. For these reasons, all members of management must be kept current on all phases of the company's business, policies and wishes, and must understand the breadth and nature of their responsibilities.

In most South American companies, for example, managers meet or communicate by phone to develop and discuss the company's plan on a daily basis.

Contrary to normal business practice in the United States, communication between managers in South America is almost always verbal. In the words of one South American executive, "you can't manage by sitting at your desk" during hyperinflation. Letters and memos between managers are virtually nonexistent, because the time involved in preparing, transmitting and reading them is simply too wasteful. It is important that American managers realize that, because of the rapidity of change brought on by high inflation, the window available for seizing an opportunity or solving a problem can easily close while written messages are exchanged.

■ *Seek appropriate amortization and depreciation techniques to accurately reflect inflationary effects on capital.*

One of the key difficulties South American companies have in pricing their products is their governments' refusal to allow them to factor in such items as amortization and depreciation of fixed assets at the inflated replacement costs.

The current United States depreciation policy — which is based on original purchase costs — will have to change to allow American companies to adjust their depreciation to accurately reflect the inflationary impact on their replacement costs.

- Make planning a daily or weekly practice.
- Prepare to communicate verbally with all key operation managers on a daily basis.
- Seek appropriate amortization and depreciation techniques to accurately reflect inflationary effects on capital.

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