A Work Project, presented as part of the requirements for the Award of a Master's degree in Management from the Nova School of Business and Economics.

GALLO: BRAND LAUNCH IN HUNGARY, EVALUATING THE POTENTIAL GEOGRAPHIC EXPANSION TO THIS MARKET:

PRICING STRATEGY FOR GALLO IN HUNGARY

MARIANA MATOSO CARRASCO PORTELA MARQUES | 32492

Work Project carried out under the supervision of

Professor Jorge Velosa

and the assistance of Carolina Lourenço

06-01-2020

1. Pricing

Marketing consists of four key elements: the product, its promotion, its placement or distribution and its price (Nagle & Müller, 2018). While product, promotion and placement comprise the company's effort to create value in the market and, therefore, produce costs, pricing, on the contrary, is the only element in the mix that converts that value into revenue. Hence, "price communicates to the market the company's intended value proposition of its products or brand" (Kotler, Keller, Brady, Goodman & Hansen, 2009). Besides producing revenue, it is also one of the most flexible elements of the mix. It can be changed quickly when compared to the product features or channel commitments (Kotler, Armstrong, Wong & Saunders, 2008).

Nevertheless, price remains the number one problem of many marketeers. As Nagle and Müller (2018) state, managers commonly have flawed thinking about pricing that often leads to conflict and drives them to make unprofitable decisions. It is key to get pricing right because it is the quickest and most efficient way to increase profits. "The right price will boost profits faster than increasing volume, the wrong price can shrink profit just as quickly" (Zawada, Baker & Marn, 2010). Consequently, it is crucial to understand what pricing paradigms are flawed, so that an informed decision regarding the pricing strategy of Gallo can be made.

The first paradigm to be analysed is **cost-plus pricing**, which is the most common procedure used by companies. It can be described as "setting prices based on the costs of producing, distributing and selling the good, plus a fair rate of return for effort and risk" (Kotler et al., 2008). The problem with this approach is straightforward, the mark-up solely works if the expected level of sales is achieved. Thus, "cost-plus pricing leads to overpricing in weak markets and underpricing in strong ones" (Nagle & Müller, 2018). The second approach is **shared-driven pricing** or competition-driven pricing. Defined as making a pricing decision based on the prices of competitors to gain more market share in volume. However, in the majority of cases, there is no reason why a company should seek to achieve market share as an end itself (Nagle & Müller, 2018). It has the drawback of being a short-term benefit since competitors can easily match the price cut and start a price-war. Moreover, even though, product differentiation, promotion (e.g. advertising) or distribution do not improve sales as rapidly as a price cut, their benefits, in the long-term, are more sustainable and cost-effective.

Ultimately, the last paradigm to be examined is customer-driven pricing or **value-based pricing**. In this approach, cost information is relevant, yet the final pricing decision is driven by marketing and sales. The purpose of strategic pricing is to price more profitably by capturing more value, not necessarily by making more sales (Nagle & Müller, 2018). Thus, value-based pricing can be outlined as the practice of setting prices according to customers' willingness to pay. "Significant inputs in this approach are market factors such as prices of competitive products, prices customers indicate they are willing to pay, and comments from customers about price sensitivity*"* (Smith & Nagle, 1994).

After analysing these three pricing paradigms, value-based pricing was the approach chosen for Gallo's entry in Hungary once it is the one that offers the most advantages and places the main focus on the customers and what they value. Thus, it ends up being the most profitable pricing approach since customers do not pay attention to how much a product costs to produce or how much competitors are charging, instead, their main concern is how much value they are receiving at a particular price.

1.1. Value-based Pricing Approach

"While the design and implementation of a true value-based pricing approach requires a commitment to systematic, rigorous work, the returns on that effort can be substantial" (Dolan & Gourville, 2014). According to the authors (2014), this approach relies on two main elements – value orientation and processes. A company should focus on the economic value created by the product for a given target and should set processes to capture a portion of that value for the firm. The value-based thermometer (Exhibit 1) is often used as an approach to schematize the three key inputs to any value-based decision: the true economic value (TEV), perceived value (PV) and cost of goods sold (COGS). The true economic value is the value a fully informed buyer would attribute to a product. Whereas, perceived value reflects the buyer's willingness to pay, that is, the value that they perceive in the product. Consequently, perceived value is often less than the true economic value. Lastly, the cost of goods sold is the variable cost of producing the product (Exhibit 2).

2. Pricing Strategies

After outlining a price range in line with the true economic value and customers' perceived value, it is important to specify in which range the company could reasonably expect to operate more profitably. Price levels need to be set to support and improve the broader marketing objectives of the firm. Thus, *"pricing objectives are defined in terms of the share of differentiating value that the firm attempts to capture in its price"* (Nagle & Müller, 2018). A company can choose between three pricing strategies: market skimming, market penetration and neutral market pricing.

The first approach **(Market Skimming)** is designed to capture superior margins, even at the expense of large sales volume (Nagle & Müller, 2018). With this strategy, price is set at a very high level concerning what the majority of buyers in a segment would be willing to pay. Therefore, *"it only optimizes immediate profitability when the profit from selling to relatively price-insensitive customers exceeds that from selling to a larger market at a lower price"* (Nagle & Müller, 2018). In some cases, products might earn more profit in the long term by doing **sequential skimming**. That is, setting initial prices high and reducing them over time, which is a more common strategy for products and services with low repurchase rate (Nagle & Müller, 2018). Nevertheless, in both cases, several efforts in communicating the differential value need to occur in order to justify the high price to consumers.

Market penetration can be defined as setting a price low enough to entice and hold a sizeable base of customers. "Penetration prices are not necessarily cheap, but they are low relative to the perceived value in the target segment" (Nagle & Müller, 2018). This strategy will only work if a large portion of the market is willing to switch brands in response to a lower price. Naturally, for this strategy to be successful, competitors ought to allow a company to set the lower price without retaliating. Furthermore, conditions are more favourable for penetration pricing when incremental costs (variable and incremental fixed) represent a small share of the price so that each additional sale makes a large contribution to profit (Nagle & Müller, 2018).

Neutral pricing is the strategy to not use price in order to gain market share but at the same time not letting price alone to restrict it. "Neutral pricing minimizes the role of price as a marketing tool in favour of other tactics that management believes are more powerful or cost-effective for a product's market" (Nagle & Müller, 2018). This approach tends to be chosen when market conditions cannot support either a skimming or penetration strategy. For instance, when the product is switchable and, consequently, buyers will not pay a premium or, once the product is a newcomer, customers judge low quality from the low price. This latter is also known for "price-quality effect".

Focusing on Gallo, the strategy chosen is **market skimming** because the brand will offer more than just a product, giving consumers an innovative, healthy culinary experience. Therefore, it will be positioned as a premium brand with a price far above competitors - the highest in the Hungarian market. Substantial marketing and communication efforts will be made to inform consumers about the differentiating features of the product and justify the high price. To keep the premium image, no sequential skimming should be made in the following years.

3. Gallo's Pricing

To create a value-based pricing approach for Gallo, it is necessary to understand which benefits drive value for customers in order to triangulate the way to a cost-effective value proposition (Nagle & Müller, 2018). The selected targets: "Lifestylers" and "Triers", desire to follow a healthy lifestyle without compromising the pleasure of eating well. The main difference between them is that “Lifestylers” regularly use olive oil to cook and as a dressing. While “Triers” feel that it does not combine with all the food they cook or believe in the myth that when olive oil is heated up, it loses properties (Mariana et al, 2020). Consequently, they use other cooking oils/fats such as sunflower oil or butter with the same frequency as olive oil. The main reasons for having started using olive oil is seeking a healthy lifestyle and taste. The target truly values a high-quality, delicious and healthy olive oil showing willingness to pay a premium for it. Bearing this in mind, the following **value-based pricing strategy with a skimming approach** was selected. The prices are going to be presented in both euros and HUF. The exchange rate considered was 330.64 HUF (exchange rate from Google Finance, December 10, 2019, 13h). In addition, it is assumed that the cost of goods sold, in which is included the production costs, label alterations, raw material and transportation remains constant.

3.1. Gallo Paprika 250 mL for Retailers

The first step to define the pricing for 250 mL Gallo Paprika is to identify the next best competitive alternative because “the feasible price floor for a product that is positively differentiated is the price of the next-best competitive alternative” (Nagle & Müller, 2018). In this case, the next best competitive alternative is *Kania*. A private label from Lidl that offers 200 mL flavoured spray olive oil. The brand has flavours such as Garlic and Chili and its priced at 3.02 euros (around 999 HUF). However, Gallo’s differential value lies in the fact that it offers a healthy innovative culinary experience that fits the Hungarian cuisine. Moreover, since 1919, Gallo is the master of selecting the best and nutritious olive oils, being able to deliver the highest quality when compared to a private label. As such, Gallo Paprika will be priced at 4.23 euros (about 1,399.00 HUF), having a differential value of 1.21 euros (about 340.56 HUF).

Concerning customers’ perceived value, it is important to mention that Hungarians show openness to flavoured olive oil. In fact, 52% of the respondents from the quantitative research demonstrated an interest in it. Furthermore, the flavour paprika was not randomly chosen, after researching the market, it was found that paprika is Hungary's spice obsession. Paprika is to Hungarian cuisine what olive oil is to Mediterranean countries. Indeed, it is present in the majority of traditional recipes such as *goulash* or *chicken paprikash*. Gallo Paprika would keep the tradition and taste alive while making a healthier dish. Simultaneously, it would demonstrate to the target customers, such as the "Triers", that olive oil does fit the Hungarian gastronomy (Mariana et al, 2020).

A company's price and marketing activities must work together. In this case, Gallo will invest in marketing activities to increase perceived value and charge a high price to capture the perceived value created (Dolan & Gourville, 2014). Having as an advantage the fact that the olive oil category in Hungary does not communicate a lot and the dominant media mix chosen is print, Gallo's communication plan will stand out from the competition and capture prospective customers attention. A campaign will be developed in both traditional media and digital (detailed description in Mariana et al, 2020). So, it is anticipated that consumers would perceive a great value for this out of the box creation and would be willing to pay for this differential attribute.

The COGS of Paprika are calculated assuming the same costs of the 250 mL flavoured olive oils sold on the Polish market, namely 1.24 euros (corresponding to 409.17 HUF). This innovation will have a contribution margin similar to Gallo *Reserva* (23%) since it is a very distinctive and differentiated product. Thus, the wholesale price is 1.60 euros (528.76 HUF). Concerning the margins for the remaining players, that is, the retailer (40% if it is a big retailer like Tesco or Spar) and the distributor (20%), they are calculated based on the Final Consumer Price without VAT (3.33 euros or 1,101.57 HUF). Thus, a big retailer will receive 1.33 euros (about 440.63 HUF) and the distributor 0.40 cents (around 132.19 HUF). Since Paprika will also be present in small independent stores such as Diéta Life Market, in which the margin is higher (around 50%), the final consumer price for that channel is going to be 5.08 euros (around 1,678.82 HUF). Exhibit 3 offers a closer look at the margin setups of each player.

3.2. Gallo Clássico 500 mL for Retailers

Regarding the pricing for Gallo Clássico in Retailers, the next best alternative is the market leader Bertolli which is perceived as a high-quality, well-known, Italian brand. Bertolli's product that can be considered the best competitive alternative is *Originale* (500 mL) which contains an acidity identical to Gallo (0.5%) and is also a moderate intensity extra virgin olive oil. *Originale* is priced at 5.44 euros (around 1,799 HUF). Considering Gallo's performance differential - being a premium southern European brand, that offers a delightful healthy twist to a culinary experience and knowing that none of the respondents from the quantitative research found Bertolli an innovative brand, the final consumer price with VAT of 500 mL Gallo Clássico is 6.65 euros (around 2,199 HUF). A differential value equivalent to 1.21 euros (corresponding to 400.07 HUF). Although, having established the price at 6.65 euros, unless potential customers understand the product's value and how it differs from competitors, the pricing strategy will fail. Thus, to raise consumers' perceived value, other elements of the mix have great importance, such as communication. *"The role of value and price communications, therefore, is to convey the value proposition in a compelling manner to accomplish three goals: enable customers to fully understand the benefits; improve their willingness-to-pay; and increase the likelihood of purchase"* (Nagle & Müller, 2018). Gallo's launch campaign was planned in accordance with this and has as objectives emphasizing the daily use of olive oil and a healthy twist to a culinary experience, mentioning quality and taste and downplaying tradition. Through several communication initiatives like product placement in the most-watched Hungarian culinary TV show (*A Konyhafonok)* or Gallo's Gastronomic route, the perceived value of consumers is expected to increase as the psychological benefits are reinforced (Mariana et al, 2020). Likewise, the product's selection (Gallo Clássico) and label alterations were also made bearing in mind increasing consumers' perceived value. To begin with, the choice of Clássico was made because from the quantitative research, respondents preferred an olive oil with a medium intensity flavour.

Moreover, the label was altered to dark green to be easier for consumers to identify it as olive oil. The rooster was painted in gold to look more premium while also being less accentuated since it caused confusion among interviewees/respondents. Additionally, to be easier for consumers to assess the quality of the olive oil without trying it, a "+200 awards" sticker was added to the bottle. Furthermore, the channels in which Gallo will be distributed will also play an important role in the perceived value of consumers. Undeniably, these channels can be seen as strategic asses as they can increase customer satisfaction, reduce distribution costs or minimize competitor rivalry (Palmatier, Stern, & El-Ansary, 2014). Being present in off-trade (HORECA), in tactical restaurants, will increase Gallo's value as a high-quality, healthy brand. Additionally, certain retailers like Diéta Life Market that aim to educate consumers in regard to healthy eating habits, are another great way to communicate Gallo's value proposition (Mariana et al, 2020).

Considering all the above and knowing that when comparing the bottles of Bertolli, Monini and Gallo, 56% of the respondents perceived Gallo as the highest quality and more expensive brand, the established price is expected to meet consumers perceived value.

In what concerns the cost of goods sold, according to Gallo, a bottle of 500 mL costs 2.10 euros (around 694.34 HUF). Regarding the margins for each player, Gallo has a contribution margin of 16% (0.41 cents on a bottle). Therefore, the wholesale price will be 2.51 euros (831.12 HUF). The margins for both the retailer and distributor are the same as in Paprika, namely 40% for the former and 20% for the latter, which are calculated based on the Final Consumer Price without VAT (5.24 euros or 1,731.50 HUF). Hence, retailers receive 2.09 euros (about 692.60 HUF) and distributors 0.63 cents (around 207.78 HUF). Similarly, Clássico will also be present in independent small stores, where the margin charged is higher (50%), hence the final consumer price with VAT will be 7.98 euros (2,638.80 HUF). Exhibit 4 offers a closer look at the margin setups of each player.

3.3. Gallo Clássico 250 mL for HORECA

Finally, considering Clássico 250mL for the HORECA channel, no next best alternative was considered because, from the quantitative research, over 72% of respondents stated that they do not recall the brand of olive oil present on the table. Making an assumption that, the majority of restaurants have unbranded olive oil bottles, no other competitor is strong on this channel. The targeted restaurants are Healthy, Brunch and Modern and what they truly value is how to provide a high-quality, tasty and innovative experience to their customers. Thus, Gallo will be a great fit as it owns a deep accumulated knowledge laid on a unique human mastery on selecting the best and nutritious olives offering a healthy twist to any culinary experience.

To assure that restaurants perceive the true value of Gallo and choose it for front of house, two elements of the mix play an important role. For starters, the product itself touches every sense of the human body, from the touch and holding of the bottle to its mate label and the colour of the olive oil. Restaurants want to provide their customers with the best experience possible, with a premium and award-winning olive oil like Gallo on the table, that will be granted. Besides the product, communication will play an important part in augmenting restaurants' willingness to pay. The initiative of the partnership with chef Miguel Rocha Vieira, with three Michelin stars, will boost Gallo's reputation as a high-quality brand and thus increase restaurants willingness to pay. Similarly, Gallo's gastronomic routes will increase restaurants' brand awareness and the number of visits. Considering all the above, the perceived value of restaurants is expected to be high.

Being present in HORECA also has the goal to increase customers perceived value. The main aim of this channel is brand building, that is to generate brand awareness, so that when customers are in retailers, they recognize Gallo, associate it with high quality (from being present in Restaurants) and ultimately purchase it.

The cost of goods sold of a bottle of 250 mL is 1.18 euros (0.93 cents that include production costs, label alterations and raw material, plus 0.25 cents of transportation costs). As there is one less player (there is no retailer), Gallo has a higher contribution margin of 27% corresponding to 0.43 cents per bottle sold. So, the wholesale price is 1.61 euros (530.91 HUF). Focusing on the outstanding player, the distributor has 25% margin under the final HORECA price without VAT (2.14 euros or 707.87 HUF). Consequently, the distributor receives 0.54 cents (about 176.97 HUF). Exhibit 5 offers a closer look at the margin setups of each player.

4. REFERENCES

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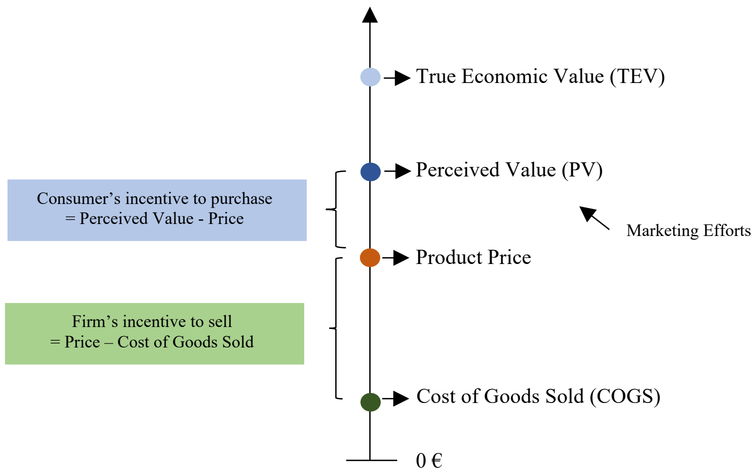
5. APPENDICES

Exhibit 1: Value-based thermometer



Source: Adapted from Dolan & Gourville (2014), *Pricing Strategy,* Harvard Business Publishing

Exhibit 2: Detailed explanation of the key inputs of a Value-based Pricing Approach

True Economic Value (TEV)

The TEV is the value that a fully informed buyer would or should ascribe to the product (Dolan & Gourville, 2014). Noticeably, different customer segments obtain different TEVs as their needs and preferences are distinctive. Similarly, it is important to notice that "value is not determined by the unchanging physical aspects of the product but by the ever-changing circumstances of the customer" (Nagle & Müller, 2018). Hence, their preferences can change if they obtain a new information or purchase the product in a different context. In order to calculate the true economic value, two key components need to be taken into account: the next best alternative and the value of the performance differential which can be *monetary* or *psychological*. The former denotes the total savings that a customer would have if they purchased that product/service, while the latter, stands for the several ways a product/service can create satisfaction for the customer. Nonetheless, a product can be superior when compared to the next best alternative in some scopes while inferior in others. "The TEV is a critical input to understand the customer's underlying economics, the performance of competitors' products, and the relative advantage or disadvantage offered by the focal product" (Dolan & Gourville, 2014).

Perceived Value (PV)

While TEV represents the price a fully informed shopper would be willing to pay for a certain product, perceived value is usually less. In reality, "a buyer's willingness to pay is governed by the value she or he perceives in the new product" (Dolan & Gourville, 2014). PV is less as consumers are usually unaware of all the benefits that the product has to offer or are sceptical about them. The degree to which PV approaches TEV can often be influenced by the level and quality of the marketing efforts directed toward the customer (Dolan & Gourville, 2014). The PV is the upper bound of the value-pricing thermometer meaning that the price should not be set above this value, which is directly influenced by the TEV of the product for a certain buyer and the marketing efforts made to communicate the TEV.

Cost of Goods Sold (COGS)

The final input is the company's cost of goods sold (COGS) which corresponds to the lower bound of the pricing thermometer. Consequently, a company will not price the product lower than this value, otherwise it would incur losses. This value can be obtained from the income statement of the company and it represents the fully loaded variable cost of producing the product being sold (Dolan & Gourville, 2014).

Exhibit 3: Gallo Paprika for Big Retailers (e.g Tesco, Spar) and Small Independent Stores (e.g. Diéta) – Margins for each player

Retailers: Gallo Paprika	HUF	EURO
Price per 1 LT	5596.00	16.92
Final Consumer Price (250ml)	**1399.00**	**4.23**
VAT	27%	27%
Consumer Price without VAT	**1101.57**	**3.33**
Retailer Margin Value	440.63	1.33
% Margin	40%	40%
Distributor Margin Value	132.19	0.40
% Distributor Margin	20%	20%
Wholesale Price	**528.76**	**1.60**
Cost of Goods sold	409.17	1.24
Margin	119.59	0.36
% Contribution Margin	23%	23%

Dieta Life Market: Gallo Paprika	HUF	EURO
Price per 1 LT	6715.28	20.31
Final Consumer Price (250ml)	**1678.82**	**5.08**
VAT	27%	27%
Consumer Price without VAT	**1321.91**	**4.00**
Retailer Margin Value	660.95	2.00
% Margin	50%	50%
Distributor Margin Value	132.19	0.40
% Distributor Margin	20%	20%
Wholesale Price	**528.76**	**1.60**
Cost of Goods sold	409.99	1.24
Margin	118.77	0.36
% Contribution Margin	23%	23%

Exhibit 4: Gallo Clássico for Big Retailers (e.g Tesco, Spar) and Small Independent Stores (e.g. Diéta) – Margins for each player

Retailers: Gallo Clássico	HUF	EURO
Price per 1 LT	4398.00	13.30
Final Consumer Price (500ml)	**2199**	**6.65**
VAT	27%	27%
Consumer Price without VAT	**1731.50**	**5.24**
Retailer Margin Value	692.60	2.09
% Margin	40%	40%
Distributor Margin Value	207.78	0.63
% Distributor Margin	20%	20%
Wholesale Price	**831.12**	**2.51**
Cost of Goods sold	694.34	2.1
Margin	136.77	0.41
% Contribution Margin	16%	16%

Dieta Life Market: Gallo Clássico	HUF	EURO
Price per 1 LT	5277.60	15.96
Final Consumer Price (500ml)	**2638.80**	**7.98**
VAT	27%	27%
Consumer Price without VAT	**2077.80**	**6.28**
Retailer Margin Value	1038.90	3.14
% Margin	50%	50%
Distributor Margin Value	207.78	0.63
% Distributor Margin	20%	20%
Wholesale Price	**831.12**	**2.51**
Cost of Goods sold	694.344	2.1
Margin	136.77	0.41
% Contribution Margin	16%	16%

Exhibit 5: Gallo Clássico for HORECA – margins for each player

Horeca: Gallo Clássico		
	HUF	**Euro**
HORECA with VAT	899.00	2.72
VAT	27%	27%
HORECA final price (250 ml)	**707.87**	**2.14**
Distributor Margin Value	176.97	0.54
% Distributor Margin	25%	25%
Wholesale Price	**530.91**	**1.61**
Cost of Goods sold	390.16	1.18
Margin	140.75	0.43
% Contribution Margin	27%	27%