CASE 16.1
Blood Diamonds

1. Evaluate DeBeers's pricing practice.

There is a relationship between price and supply. When the supply of a product or commodity is high, its price is depressed. A low supply, on the other hand, drives up the product's price. This explains why OPEC countries have been able to push up the price of crude oil in the last several years. In early 2004, for example, as demand slowed, OPEC announced that its members would cut back on production. Consequently, the high gasoline prices are being maintained. In 2008, as oil price approached $110 a barrel, OPEC refused to increase production. With tight supply, strong demand, and a great deal of speculation, oil price was kept high.

Diamonds, likewise, respond pretty much to the same relationship. However, there is one major difference between diamonds and oil. Oil is more of a necessity. Diamonds, in contrast, are more of a discretionary purchase, and such purchases can be postponed (when necessary). Still, diamonds and their prices react to the world's supply and demand.

DeBeers controls the supply of diamonds to a large degree. Its usual practice is to invite companies for "sight" where they are offered a certain quantity at a specified price. Price haggling is not allowed. Companies do not have to buy what is offered, but they will not be invited back for another "sight." This strategy is most effective when DeBeers is (or is perceived to be) the only game in town. Since companies do not have a viable and long-term alternative, they simply have to go along with DeBeers's practice.

For DeBeers to maintain its power, it must be able to control the amount of diamonds to be made available to the world market. As such, it is obligated to buy rough diamonds from virtually any producers. On the one hand, it has to offer prices that are reasonably attractive so as to prevent the producers from bypassing DeBeers. On the other hand, it must be able to finance its expensive inventory, especially when demand is slow and when supply rapidly increases.

DeBeers's pricing aim is to make the market as well as the price stable. It is willing to sacrifice extra profits in the booming period in order to avoid heavy losses and price cutting in the period of declining demand. DeBeers's pricing is based on its semi-monopoly situation. The problem with this pricing strategy is that DeBeers is not a true monopolist. Several countries market their diamonds to users while bypassing DeBeers. Also DeBeers has to lower prices during recession because of weak demand. Still the strategy makes sense, assuming that the company can control the large portion of supply--large enough to control the market.

2. Evaluate DeBeers's attempt to promote a new image.

As a cartel, DeBeers does not have a good image to begin with. In the United States, the largest diamond market in the world, a cartel is illegal. That explains why DeBeers executives avoid traveling to the United States where they can be arrested. Interestingly, OPEC countries

and their government officials have no such problem. Actually, OPEC countries even have a significant amount of influence on the policies of the U.S. government.

The fact that DeBeers is (or, at least, was) involved with blood diamonds damaged the cartel's image even more. The brutality and cruelty of the rebel groups have made it difficult for the world to ignore the sufferings of Angolans. Certainly, DeBeers cannot afford to antagonize the U.S. government. In addition, its tarnished image could invite the other governments to impose sanctions.

So it was a smart move on the part of DeBeers to promote itself as a responsible organization. By refusing to buy rough diamonds from Angola, Congo, and Sierra Leone, it can claim that it has lived up to its social obligations. Moreover, it no longer has to stockpile expensive diamonds, thus cutting down on its inventory costs. Yet, DeBeers does not really have to loosen control on the supply of diamonds. Because of a global accord that stops trade in diamonds from the conflict zones, this excess supply is automatically contained.

3. Will consumers care where a diamond comes from?

For a marketer to have pricing freedom, its offering must be perceived by its customers as a product rather than a commodity. A commodity is an undifferentiated, often unbranded, product. In contrast, a product is a value-added, differentiated, and branded commodity. Commodities (e.g., corn, soybeans, beef, steel, etc.), interestingly, have no pricing problem since the producers of commodities cannot do anything about their prices anyway. They simply have to accept and adhere to a market price. Because their offerings are not different from those offered by competitors, they cannot ask for an above-market price. Buyers simply refuse to pay more because they can buy exactly the same commodity at the market price from the other producers. Along the same line, there is absolutely no reason for any producers to cut their prices since they can already sell all they can at the prevailing market price.

It should be evident that diamonds are basically a commodity. Consumers have no good reason to believe that diamonds from particular countries (e.g., South Africa, Canada, the United States, etc.) are superior. After all, the pricing of a diamond is based on a standard formula related to the 4 Cs (carat, clarity, cut, and color). Diamonds can be certified and priced by the GIA and other organizations. Therefore, a standardized pricing formula can be used.

It is possible that particular diamonds (e.g., the Hope diamond) may have acquired a unique mystique or image, but such diamonds are extremely few. It is also true that some couples may want to associate diamonds with romance and that they want to stay away from anything that is associated with torture and suffering. This insistence, however, means that they will have to pay more for comparable diamonds. It is doubtful that most people will be willing to pay such a premium.

Chapter 7 discusses the relationship between country of origin and perceived product quality. The discussion also mentions that, regardless of the country of origin, the perceived image of a product can be influenced by brand image as well as the image of a retailer. In this case, country of origin is unlikely to matter. Since diamonds are not branded, brand image is not

an issue either. Nevertheless, the prestige of a retailer can be something else altogether. Tiffany's, for example, has an elegant image. According to Tiffany's, people buy diamonds from Tiffany's because of its reputation--not because its diamonds come from a particular country.