Global Business Today 6e

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Chapter 13

Exporting, Importing, and Countertrade

Introduction

Question: What type of firm benefits from exporting?

- Both large and small firms can benefit from exporting
- The volume of export activity in the world economy is increasing as exporting has become easier thanks to
  - the decline in trade barriers under the WTO
  - regional economic agreements such as the European Union and the North American Free Trade Agreement

Introduction

Question: What do firms that want to export need to do?

- Firms wishing to export must
  - identify export opportunities
  - avoid a host of unanticipated problems associated with doing business in a foreign market
  - become familiar with the mechanics of export and import financing
  - learn where to get financing and export credit insurance
  - learn how to deal with foreign exchange risk

The Promise and Pitfalls of Exporting

Question: What are the benefits of exporting?

- The benefits from exporting can be great--the rest of the world is a much larger market than the domestic market
- Larger firms may be proactive in seeking out new export opportunities, but many smaller firms take a reactive approach to exporting
- Many novice exporters have run into significant problems when first trying to do business abroad, souring them on following up on subsequent opportunities

The Promise and Pitfalls of Exporting

Question: What are the pitfalls facing exporters?

Common pitfalls for exporters include

- poor market analysis
- poor understanding of competitive conditions
- a lack of customization for local markets, poor distribution arrangements, bad promotional campaigns
- a general underestimation of the differences and expertise required for foreign market penetration
- difficulty dealing with the tremendous paperwork and formalities involved

Improving Export Performance

Question: How can exporters improve their performance?

- To improve their success, exporters should
  - acquire more knowledge of foreign market opportunities
  - consider using an export management company
  - adopt a successful export strategy

An International Comparison

- Many firms fail to consider export opportunities simply because they lack knowledge of the opportunities available
- Both Germany and Japan have developed extensive institutional structures or promoting exports
- Japanese exporters can also take advantage of the knowledge and contacts of sogo shosha, the country's great trading houses

Information Sources

- The U.S. Department of Commerce is the most comprehensive source of information for U.S. firms
- Firms can get a "best prospects" list of potential foreign distributors
- Firms can also participate in trade fairs or get assistance from the Small Business Administration

Utilizing Export Management Companies

Question: What assistance can exporters get from export management companies?

- Export management companies are export specialists that act as the export marketing department or international department for client firms
- EMCs
  1. start exporting operations for a firm with the understanding that the firm will take over operations after they are well established
  2. start services with the understanding that the EMC will have continuing responsibility for selling the firm's products

Export Strategy

Question: What steps should exporters take to increase their chances of success?

- Exporters
  - can hire an EMC to help identify opportunities and navigate paperwork and regulations
  - start by focusing initially on just one or a few markets
  - enter a foreign market on a fairly small scale in order to reduce the costs of any subsequent failures

Export Strategy

- Exporters should also
  - recognize the time and managerial commitment involved in building export sales
  - devote attention to building strong and enduring relationships with local distributors and customers
  - hire local personnel to help the firm establish itself in a foreign market
  - keep the option of local production

Export and Import Financing

Question: How can firms deal with the lack of trust that exists in export transactions?

- Various mechanisms for financing exports and imports have evolved over the centuries in response to lack of trust that exists in export transactions

Lack of Trust

- Exporters and importers have to trust someone who may be very difficult to track down if they default on an obligation
- Each party has a different set of preferences regarding the configuration of the transaction
  - Exporters prefer to be paid in advance, while importers prefer to pay after shipment arrives
- Problems arising from the lack of trust can be solved by using a third party who is trusted by both - normally a reputable bank

Letter of Credit

- A letter of credit is issued by a bank at the request of an importer and states the bank will pay a specified sum of money to a beneficiary, normally the exporter, on presentation of particular, specified documents
- This system is attractive because both parties are likely to trust a reputable bank even if they do not trust each other

Draft

Question: How is payment actually made in an export transaction?

- Most export transactions involve a draft, also called a bill of exchange
- A draft is an order written by an exporter instructing an importer, or an importer's agent, to pay a specified amount of money at a specified time
- A sight draft is payable on presentation to the drawee while a time draft allows for a delay in payment - normally 30, 60, 90, or 120 days

Bill of Lading

- The bill of lading is issued to the exporter by the common carrier transporting the merchandise
- It serves three purposes
  - it is a receipt
  - it is a contract
  - it is a document of title

Classroom Performance System

An order written by an exporter instructing an importer to pay a specified amount of money at a specified time is

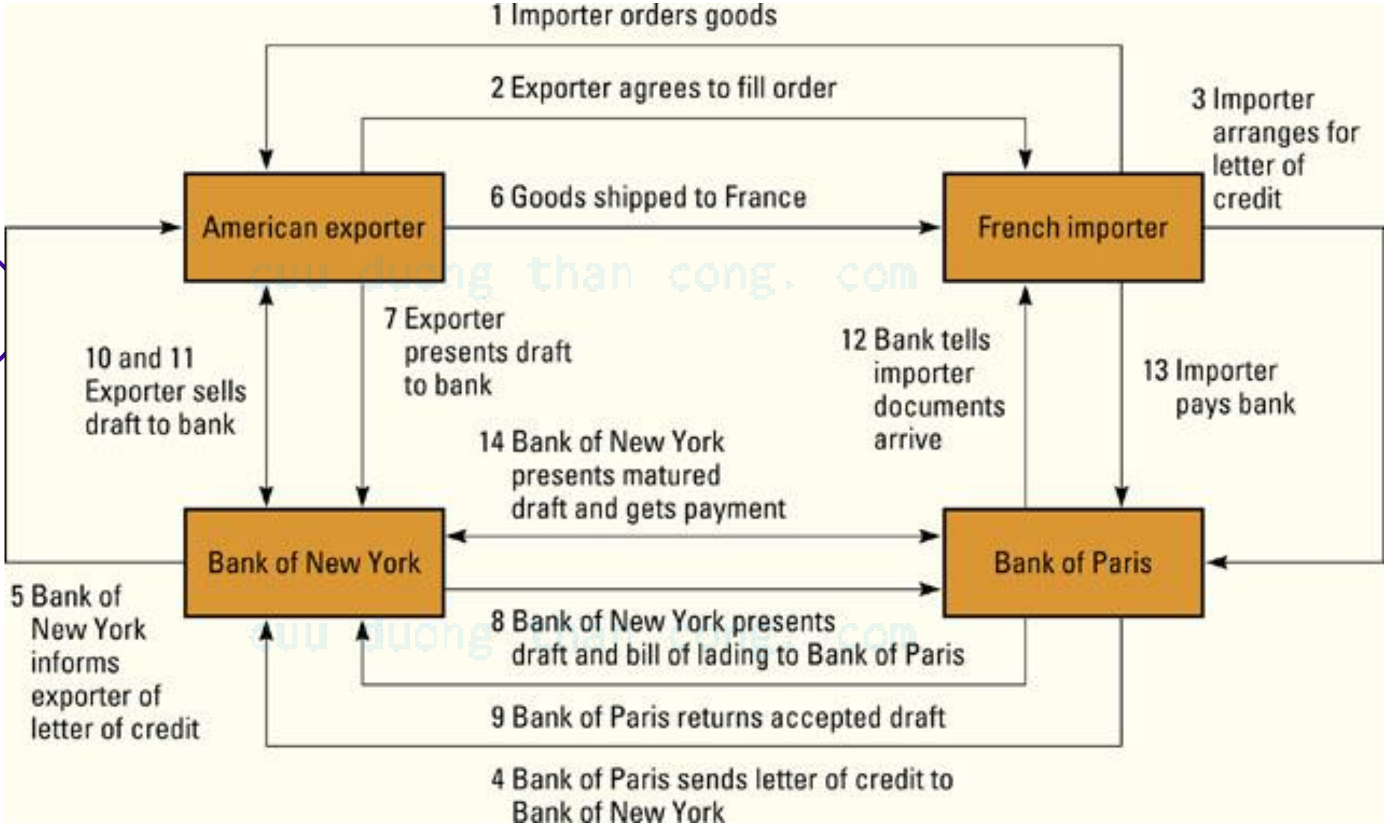
a) A letter of credit

b) A draft

c) A bill of lading

d) A confirmed letter of credit

A Typical International Transaction



Classroom Performance System

A bill of lading serves all of the following purposes except

a) It is a receipt

b) It is a contract

c) It is a document of title

d) It is a form of payment

Export Assistance

Question: Where can exporters get financing help?

- U.S. exporters can draw on two forms of government-backed assistance to help their export programs
  1. they can get financing aid from the Export-Import Bank
  2. they can get export credit insurance from the Foreign Credit Insurance Association

Export-Import Bank

1. The Export Import Bank

- The Export-Import Bank (Eximbank) is an independent agency of the U.S. government
- Its mission is to provide financing aid that will facilitate exports, imports, and the exchange of commodities between the U.S. and other countries

Export Credit Insurance

2. Export Credit Insurance

- In the U.S., export credit insurance is provided by the Foreign Credit Insurance Association (FICA)
- FICA provides coverage against commercial risks and political risks

Countertrade

Question: What alternatives do exporters have when conventional methods of payment are not an option?

- Exporters can use countertrade when conventional means of payment are difficult, costly, or nonexistent
- Countertrade refers to a range of barter-like agreements that facilitate the trade of goods and services for other goods and services when they cannot be traded for money

The Incidence of Countertrade

- In the 1960s the Soviet Union and the Communist states of Eastern Europe, whose currencies were generally nonconvertible, turned to countertrade to purchase imports
- Many developing nations that lacked the foreign exchange reserves required to purchase necessary imports turned to countertrade during the 1980s
  - There was a notable increase in the volume of countertrade after the Asian financial crisis of 1997

Types of Countertrade

- There are five types of countertrade

1. barter
2. counterpurchase
3. offset
4. switch trading
5. compensation or buyback

Types of Countertrade

1. Barter

- Barter, the most restrictive countertrade arrangement, is a direct exchange of goods and/or services between two parties without a cash transaction
- It is used primarily for one-time-only deals in transactions with trading partners who are not creditworthy or trustworthy

2. Counterpurchase

- Counterpurchase is a reciprocal buying agreement
- It occurs when a firm agrees to purchase a certain amount of materials back from a country to which a sale is made

Types of Countertrade

3. Offset

- Offset is similar to counterpurchase insofar as one party agrees to purchase goods and services with a specified percentage of the proceeds from the original sale
- The difference is that this party can fulfill the obligation with any firm in the country to which the sale is being made

Types of Countertrade

4. Compensation or Buybacks

- A buyback occurs when a firm builds a plant in a country—or supplies technology, equipment, training, or other services to the country—and agrees to take a certain percentage of the plant's output as a partial payment for the contract

Classroom Performance System

The use of a specialized third-party trading house in a countertrade arrangement is called

a) Buyback

b) Offset

c) Counterpurchase

d) Switch trading

The Pros and Cons of Countertrade

Question: What are the advantages and disadvantages of countertrade?

- Countertrade is a way for firms to finance an export deal when other means are not available
- Firms that are unwilling to enter a countertrade agreement may lose an export opportunity to a competitor that is willing to make a countertrade agreement
- A countertrade arrangement may be required by the government of a country to which a firm is exporting goods or services

The Pros and Cons of Countertrade

- Countertrade is unattractive because
  - most firms prefer to be paid in hard currency
  - it may involve the exchange of unusable or poor-quality goods that the firm cannot dispose of profitably
- Countertrade is most attractive to large, diverse multinational enterprises that can use their worldwide network of contacts to dispose of goods acquired in countertrading

Classroom Performance System

Which of the following is not an advantage of countertrade?

a) It may involve the exchange of unusable or poor-quality goods that the firm cannot dispose of profitably

b) It can give a firm a way to finance an export deal when other means are not available

c) It can be a strategic marketing weapon

d) It can give a firm an advantage over firms that are unwilling to engage in countertrade arrangements

Critical Discussion Question

1. A firm based in Washington State wants to export a shipload of finished lumber to the Philippines. The would-be importer cannot get sufficient credit from domestic sources to pay for the shipment but insists that the finished lumber can be quickly resold in the Philippines for a profit. Outline the steps the exporter should take to effect this export to the Philippines.

Critical Discussion Question

2. You are the assistant to the CEO of a small textile firm that manufactures high-quality, premium-priced, stylish clothing. The CEO has decided to see what the opportunities are for exporting and has asked you for advice as to the steps the company should take. What advice would you give the CEO?

Critical Discussion Question

3. An alternative to using a letter of credit is export credit insurance. What are the advantages and disadvantages of using export credit insurance rather than a letter of credit for exporting (a) a luxury yacht from California to Canada, and (b) machine tools from New York to Ukraine?

Critical Discussion Question

4. How do you explain the popularity of countertrade? Under what scenarios might its popularity increase still further by the year 2010? Under what scenarios might its popularity decline?

Critical Discussion Question

5. How might a company make strategic use of countertrade schemes as a marketing weapon to generate export sales revenues? What are the risks associated with pursuing such a strategy?