8 Importing, Exporting, and Sourcing

Europe is famous as a source for fine leather goods such as handbags and shoes. Each year, consumers in Europe buy 2.5 billion pairs of shoes. Shoes from China currently account for about one-third of the market; since 2001, when China joined the WTO, Chinese imports have increased tenfold. Imports from Vietnam have doubled in the same period. The flood of shoe imports from China and Vietnam has been a boon for European retailers and value-conscious consumers. However, faced with a threat to their business, manufacturers in Italy, Spain, and France sought protection. In an effort to curb the tide of imports, the European Commission imposed tariffs for a period of two years: 16.5 percent on shoes from China and 10 percent on shoes from Vietnam. Overall, the tariffs will affect 11 percent of the shoes sold in Europe. The vote by representatives of the EU member nations was close: 13 to 12. The narrow margin of victory for the tariffs reflects divergent views in Europe about how to deal with low-cost Asian goods. Countries that advocate free trade, including the United Kingdom, Ireland, and Sweden, oppose the tariffs. A trade group, the European Branded Footwear Coalition, also objected, noting that the tariffs would increase the price of a pair of women's boots by €6.50—more than $8.

The success of Chinese and Vietnamese exporters—and the EU's subsequent imposition of tariffs—serves as a reminder of the impact exporting and importing can have on national and regional economies. This chapter provides an overview of import-export basics. We begin by explaining the difference between export selling and export marketing. Next is a survey of organizational export activities. An examination of national policies that support exports and/or discourage imports follows. After a discussion of tariff systems, we introduce key export participants. The next section provides an overview of organizational design issues as they pertain to exporting. This is followed by a section devoted to material that can be extremely useful to undergraduates who are majoring in international business: export financing and payment methods. For many students, that all-important first job may be in the import-export department. A familiarity with documentary credits, Incoterms, and other payment-related terminology can help you make a good impression during a job interview and, perhaps, help you land a job as an export/import coordinator or administrator. The chapter ends with a discussion of outsourcing, a topic that is becoming increasingly important as companies in many parts of the world cut costs by shifting both blue-collar and white-collar work to nations with low-wage workforces.

Vietnam is home to dozens of state-run textile and apparel manufacturers that export $1 billion in clothing and footwear each year. The country's garment sector produces merchandise for Nike, Zara, The Limited, and other popular brands. Recently, Vietnam's National Textile-Garment Group (Vinatex) began working with Western consultants to transform the structure and culture of its affiliated companies.

EXPORT SELLING AND EXPORT MARKETING: A COMPARISON

To better understand importing and exporting, it is important to distinguish between **export selling** and **export marketing**. Export selling does not involve tailoring the product, the price, or the promotional material to suit the requirements of global markets. The only marketing mix element that differs is the "place"; that is, the country where the product is sold. This selling approach may work for some products or services; for unique products with little or no international competition, such an approach is possible. Similarly, companies new to exporting may initially experience success with selling. Even today, the managerial mind-set in many companies still favors export selling. However, as companies mature in the global marketplace or as new competitors enter the picture, export *marketing* becomes necessary.

Export marketing targets the customer in the context of the total market environment. The export marketer does not simply take the domestic product "as is" and sells it to international customers. To the export marketer, the product offered in the home market represents a starting point. It is modified as needed to meet the preferences of international target markets; this is the approach the Chinese have adopted in the U.S. furniture market. Similarly, the export marketer sets prices to fit the marketing strategy and does not merely extend home-country pricing to the target market. Charges incurred in export preparation, transportation, and financing must be taken into account in determining prices. Finally, the export marketer also adjusts strategies and plans for communications and distribution to fit the market. In other words, effective communication about product features or uses to buyers in export markets may require creating brochures with different copy, photographs, or artwork. As the vice president of sales and marketing of one manufacturer noted, "We have to approach the international market with *marketing* literature as opposed to *sales* literature."

Export marketing is the integrated marketing of goods and services that are destined for customers in international markets. Export marketing requires:

1. An understanding of the target market environment
2. The use of marketing research and identification of market potential

3. Decisions concerning product design, pricing, distribution and channels, advertising, and communications—the marketing mix

After the research effort has zeroed in on potential markets, there is no substitute for a personal visit to size up the market firsthand and begin the development of an actual export marketing program. A market visit should do several things. First, it should confirm (or contradict) assumptions regarding market potential. A second major purpose is to gather the additional data necessary to reach the final go or no-go decision regarding an export marketing program. Certain kinds of information simply cannot be obtained from secondary sources. For example, an export manager or international marketing manager may have a list of potential distributors provided by the U.S. Department of Commerce. He or she may have corresponded with distributors on the list and formed some tentative idea of whether they meet the company's international criteria. It is difficult, however, to negotiate a suitable arrangement with international distributors without actually meeting face-to-face to allow each side of the contract to appraise the capabilities and character of the other party. A third reason for a visit to the export market is to develop a marketing plan in cooperation with the local agent or distributor. Agreement should be reached on necessary product modifications, pricing, advertising and promotion expenditures, and a distribution plan. If the plan calls for investment, agreement on the allocation of costs must also be reached.

One way to visit a potential market is through a **trade show** or a state- or federally sponsored **trade mission**. Each year hundreds of trade fairs, usually organized around a product category or industry, are held in major markets. By attending trade shows and missions, company representatives can conduct market assessment, develop or expand markets, find distributors or agents, or locate potential end users. Perhaps most important, attending a trade show enables company representatives to learn a great deal about competitors' technology, pricing, and depth of market penetration. For example, exhibits often offer product literature with strategically useful technological information. Overall, company managers or sales personnel should be able to get a good general impression of competitors in the marketplace as they try to sell their own company's product.

ORGANIZATIONAL EXPORT ACTIVITIES

Exporting is becoming increasingly important as companies in all parts of the world step up their efforts to supply and service markets outside their national boundaries.[1] Research has shown that exporting is essentially a developmental process that can be divided into the following distinct stages:

1. The firm is unwilling to export; it will not even fill an unsolicited export order. This may be due to perceived lack of time ("too busy to fill the order") or to apathy or ignorance.
2. The firm fills unsolicited export orders but does not pursue unsolicited orders. Such a firm is an export seller.
3. The firm explores the feasibility of exporting (this stage may bypass Stage 2).
4. The firm exports to one or more markets on a trial basis.
5. The firm is an experienced exporter to one or more markets.
6. After this success, the firm pursues country- or region-focused marketing based on certain criteria (e.g., all countries where English is spoken or all countries where it is not necessary to transport by water).

[1] This section relies heavily on Warren J. Bilkey, "Attempted Integration of the Literature on the Export Behavior of Firms," *Journal of International Business Studies* 8, no. 1 (1978) pp. 33–46. The stages are based on Rogers' adoption process. See Everett M. Rogers, *Diffusion of Innovations* (New York: Free Press, 1995).

Table 8-1

Potential Export Problems

Logistics	Servicing Exports
Arranging transportation	Providing parts availability
Transport rate determination	Providing repair service
Handling documentation	Providing technical advice
Obtaining financial information	Providing warehousing
Distribution coordination	**Sales Promotion**
Packaging	Advertising
Obtaining insurance	Sales effort
Legal Procedure	Marketing information
Government red tape	**Foreign Market Intelligence**
Product liability	Locating markets
Licensing	Trade restrictions
Customs and duty	Competition overseas
Contract	
Agent-Distributor Agreements	

7. The firm evaluates global market potential before screening for the "best" target markets to include in its marketing strategy and plan. *All* markets—domestic and international—are regarded as equally worthy of consideration.

The probability that a firm will advance from one stage to the next depends on different factors. Moving from Stage 2 to Stage 3 depends on management's attitude toward the attractiveness of exporting and their confidence in the firm's ability to compete internationally. However, *commitment* is the most important aspect of a company's international orientation. Before a firm can reach Stage 4, it must receive and respond to unsolicited export orders. The quality and dynamism of management are important factors that can lead to such orders. Success in Stage 4 can lead a firm to Stages 5 and 6. A company that reaches Stage 7 is a mature, geocentric enterprise that is relating global resources to global opportunity. To reach this stage requires management with vision and commitment.

One recent study noted that export procedural expertise and sufficient corporate resources are required for successful exporting. An interesting finding was that even the most experienced exporters express lack of confidence in their knowledge about shipping arrangements, payment procedures, and regulations. The study also showed that, although profitability is an important expected benefit of exporting, other advantages include increased flexibility and resiliency and improved ability to deal with sales fluctuations in the home market. Although research generally supports the proposition that the probability of being an exporter increases with firm size, it is less clear that export intensity—the ratio of export sales to total sales—is positively correlated with firm size. Table 8-1 lists some of the export-related problems that a company typically faces.[2]

NATIONAL POLICIES GOVERNING EXPORTS AND IMPORTS

It is hard to overstate the impact of exporting and importing on the world's national economies. In 1997, for example, total imports of goods and services by the United States passed the $1 trillion mark for the first time; in 2005, the

[2] Masaaki Kotabe and Michael R. Czinkota, "State Government Promotion of Manufacturing Exports: A Gap Analysis," *Journal of International Business Studies* 23, no. 4 (Fourth Quarter 1992), pp. 637–658.

the rest of the story

Chinese and Vietnamese Imports

Officially, the EU tariffs on Chinese and Vietnamese shoe imports are known as antidumping duties. In general, such tariffs reflect a finding that products are being sold in export markets for less than the selling price in the exporter's home country. In other words, as explained in detail later in the chapter, they are being "dumped." In economic terms, China and Vietnam—both ruled by Communist governments—are considered "nonmarket economies." From the EU's point of view, this means that the two countries' domestic prices are artificial. In such countries, where many enterprises are state-owned, profitability in the Western sense is less of a priority than job creation. To prove dumping, investigators have only to compare the cost of the imported shoes with prices of shoes produced in true market economies where the laws of supply and demand determine costs and prices. In such a comparison, the Chinese and Vietnamese appear to have a significant price advantage.

The *Financial Times* noted that the tariffs reflect a triumph of the interests of a small number of EU producers at the expense of the region's 450 million consumers. As an editorial in the *Financial Times* observed, antidumping duties are usually used in large-scale, capital intensive industries such as steel. The editorial noted that, "Shoemaking is not a strategic industry with gigantic economics of call where predatory export pricing could deliver an exploitable competitive advantage. [Shoemaking] is an open global market where fierce competition will soon erode large profit margins." The editors continued, "If subsidized shoes are indeed being shipped halfway around the world to be sold off cheaply, more fool their producers. If Beijing and Hanoi want to subsidize European consumers to build their shoe collections, let them."

Shoes are not the only European industry sector protected by antidumping duties. In 2005, prompted by a complaint by the European Bicycle Manufacturers Association, the European Commission raised tariffs on Chinese bicycles from 30.6 percent to 48.5 percent and imposed a 34.5 percent tariff on bicycles from Vietnam. Some observers believed it was unfair to combine Vietnamese and Chinese bike imports in the same trade suit. They attempted to draw a distinction between the two nations by noting that Chinese bicycles are sold in supermarkets and department stores. By contrast, Vietnamese consumers buy bikes in small shops. According to this line of argument, bicycles from the two countries don't compete with each other in export markets and should, therefore, not be investigated in the same antidumping suit. However, the European Commission concluded that Vietnam and China produce the same type of bicycles and distribute them through similar channels.

Sources: John W. Miller, "EU Levies Tariffs on China, Vietnam," *The Wall Street Journal,* October 5, 2006, p. A8; John W. Miller, "EU Proposes Duties on Chinese, Vietnamese Shoes," *The Wall Street Journal,* August 31, 2006, p. A4; Juliane von Reppert-Bismarck, "EU Shoe Duty Trips Up Retailers," *The Wall Street Journal,* April 24, 2006, p. A6; "Soft Shoe Shuffle," *Financial Times,* February 27, 2006, p. 12; Raphael Minder, "Mandelson to Defy Shoe Import Furor," *Financial Times,* February 23, 2006, p. 3; Joseph Erlich, "Vietnam's Trade-War Wounds, "*The Wall Street Journal,* August 26, 2005, p. A10.

combined total was $1.9 trillion. Trends in both exports and imports reflect China's pace-setting economic growth in the Asia-Pacific region. Exports from China have grown significantly; as the chapter introduction makes clear, they are growing even faster now that China has joined the WTO. As shown in Table 8-2, Chinese apparel exports to the United States command more than a 13 percent share of the overall apparel market. Historically, China protected its own producers by imposing double-digit import tariffs. These will gradually be reduced as China complies with WTO regulations. Representatives of the furniture, textile, and apparel industries in the United States are deeply concerned about the impact increased trade with China will have on these sectors. As this example suggests, one word can summarize national policies toward exports and imports: contradictory. For centuries, nations have combined two opposing policy

Table 8-2

Market Share of Top 10 Apparel Exporting Countries to the United States, 2004 (percent)

China	13.1
Mexico	10.2
Honduras	6.0
Bangladesh	4.5
El Salvador	4.5
Hong Kong	4.1
Dominican Republic	3.9
Vietnam	3.7
Indonesia	3.4
Korea	3.2

Source: United States Census Bureau.

attitudes toward the movement of goods across national boundaries. On the one hand, nations directly encourage exports; the flow of imports, on the other hand, is generally restricted.

Government Programs that Support Exports

To see the tremendous results that can come from a government-encouraged export strategy, consider Japan, Singapore, South Korea and the so-called greater-China or "China triangle" market, which includes Taiwan, Hong Kong, and the People's Republic of China. Japan totally recovered from the destruction of World War II and became an economic superpower as a direct result of export strategies devised by the Ministry for International Trade and Industry (MITI). The four tigers—Singapore, South Korea, Taiwan, and Hong Kong—learned from the Japanese experience and built strong export-based economies of their own. Although Asia's "economic bubble" burst in 1997 as a result of uncontrolled growth, Japan and the tigers are moving forward in the twenty-first century at a more moderate rate. China, an economy unto itself, has attracted increased foreign investment from DaimlerChrysler, Hewlett-Packard, GM, and other companies that are setting up production facilities to support local sales, as well as exports to world markets.

Any government concerned with trade deficits or economic development should focus on educating firms about the potential gains from exporting. This is true at the national, regional, and local government levels. Governments commonly use four activities to support and encourage firms that engage in exporting. These are tax incentives, subsidies, export assistance, and free trade zones.

First, *tax incentives* treat earnings from export activities preferentially either by applying a lower rate to earnings from these activities or by refunding taxes already paid on income associated with exporting. The tax benefits offered by export-conscious governments include varying degrees of tax exemption or tax deferral on export income, accelerated depreciation of export-related assets, and generous tax treatment of overseas market development activities.

From 1985 until 2000, the major tax incentive under U.S. law was the **foreign sales corporation (FSC)**, through which American exporters could obtain a 15 percent exclusion on earnings from international sales. Big exporters benefited the most from the arrangement; Boeing, for example, saved about $100 million per year, and Eastman Kodak saved about $40 million annually. However, in 2000, the WTO ruled that any tax break that was contingent on exports amounted to an illegal subsidy. Accordingly, the U.S. Congress has set about the task of overhauling the FSC system; failure to do so would entitle the EU to impose up to $4 billion in retaliatory tariffs. So far, congressional efforts have been hampered by the fact that potential winners and losers from a change in the FSC law are lobbying furiously. One proposed version of a new law would benefit GM, Procter & Gamble, Wal-Mart, and other U.S. companies with extensive manufacturing or retail operations overseas. By contrast, Boeing would no longer benefit. As Rudy de Leon, a Boeing executive in charge of government affairs, noted, "As we look at the bill, the export of U.S. commercial aircraft would become considerably more expensive."[3]

Governments also support export performance by providing outright **subsidies**, which are direct or indirect financial contributions or incentives that benefit producers. Subsidies can severely distort trade patterns when less competitive but subsidized producers displace competitive producers in world markets (see Case 8-2). OECD members spend nearly $400 billion annually on farm subsidies; currently, total

[3] Edmund L. Andrews, "A Civil War Within a Trade Dispute," *The New York Times*, September 20, 2002, pp. C1, C2.

annual farm support in the EU is estimated at $100 billion. With about $40 billion in annual support, the United States has the highest subsidies of any single nation. Agricultural subsidies are particularly controversial because, although they protect the interests of farmers in developed countries, they work to the detriment of farmers in developing areas such as Africa and India. The EU has undertaken an overhaul of its **Common Agricultural Policy (CAP)**, which critics have called "as egregious a system of protection as any" and "the single most harmful piece of protectionism in the world."[4] In May 2002, much to Europe's dismay, President George W. Bush signed a $118 billion farm bill that actually *increased* subsidies to American farmers over a six-year period. The Bush administration takes the position that, despite the increases, overall U.S. subsidies are still lower than those in Europe and Japan. Congress recently voted to extend the farm bill for another five years.

The third support area is *governmental assistance* to exporters. Companies can avail themselves of a great deal of government information concerning the location of markets and credit risks. Assistance may also be oriented toward export

BRIC Briefing Book

Furniture Exports from China

Furniture imports are flooding into the United States from China. Until recently, a Chinese-made wooden table might have suffered from obvious flaws such as a warped top or loose legs. Today, however, the situation is quite different: Chinese manufacturers are improving quality and offering designs that appeal to traditional American tastes in décor. The improvements have coincided with historically low mortgage rates in the United States; as a result, a record number of Americans are buying new homes or moving into bigger existing ones. To be sure, there are drawbacks to buying something made halfway around the world. For one thing, oceangoing container ships can encounter delays, and replacement parts can be hard to obtain if a piece breaks. In the case of leather furniture, low prices may be due in part to lower quality leather or a narrower range of color choices. However, China's low labor rates—a typical worker in a furniture factory earns monthly wages equivalent to about $100—translate into reasonable prices that are attractive to budget-conscious American furniture shoppers. For example, some leather sofas from China are priced below $1,000, hundreds less than pieces made in America or Europe. Likewise, an eight-piece dining room set sells for $2,500 to $3,500; a comparable American set would cost twice as much.

The furniture industry has become one of the fastest-growing sectors of China's economy. China currently accounts for about 10 percent of global furniture exports, and some industry experts believe exports could increase 30 percent annually through the end of the decade. However, such forecasts are subject to unexpected changes in the business environment. Once such change was the Asian SARS crisis. New furniture orders fell precipitously as foreign buyers stayed away from Chinese factories and fewer Chinese traveled abroad. At the retail level, many American furniture stores began stocking pieces from non-Asian sources. Some American furniture shoppers were reluctant to buy Chinese-made goods for fear that the disease could somehow be transmitted to humans via inanimate objects. As Lynn Chipperfield, senior vice president at Furniture Brands International, the biggest furniture importer in the United States, noted, "Importing is a constant challenge even under normal circumstances. This doesn't help."

Although the SARS crisis quickly passed, China's export success has caught the attention of American manufacturers and policy makers. American furniture companies, many of which are located in North Carolina and Virginia, have been laying off employees and closing plants. A recent study by an economist at the University of California–Santa Cruz found 500,000 furniture workers lost their jobs between 1979 and 1999; 38 percent were unable to find new jobs. In response, a coalition group called the American Furniture Manufacturers Committee for Legal Trade has petitioned U.S. trade officials. The group is asking investigators to examine whether Chinese furniture prices violate U.S. antidumping statutes.

Sources: Dan Morse and Katy McLaughlin, "China's Latest Export: Your Living Room," The Wall Street Journal, *January 17, 2003, p. D1; Karby Leggett and Peter Wonacott, "The World's Economy: Surge in Exports from China Jolts Global Industry,"* The Wall Street Journal, *October 10, 2002, pp. A1, A8; Jon E. Hilsenrath and Peter Wonacott, "Imports Hammer Furniture Makers,"* The Wall Street Journal, *September 20, 2002, p. A2.*

4 John Micklethwait and Adrian Wooldridge, *A Future Perfect: The Challenge and Hidden Promise of Globalization* (New York: Crown Publishers, 2000), p. 261.

Lecong, a city in Guangdong Province, can boast that it is the "furniture capital of the world": approximately 6,000 production facilities are located nearby in the Pearl River delta. The Chinese are adept at carving and other special woodworking skills, and monthly wages are as low as $100. In 2003, China's furniture exports to the United States totaled nearly $14 billion. In mid-2004, the U.S. government imposed antidumping duties on wooden bedroom furniture imports to provide some relief for American producers. Meanwhile, Ethan Allen Interiors, Furniture Brands International, Howard Miller Company, and other U.S. manufacturers have little choice but to source at least some of their production in China.

promotion. Government agencies at various levels often take the lead in setting up trade fairs and trade missions designed to promote sales to foreign customers.

The export or import process can entail red tape and bureaucratic delays. This is especially true in emerging markets, such as China and India. In an effort to facilitate exports, countries are designating certain areas as **free trade zones (FTZ)** or **special economic zones (SEZ)**. These are geographic entities that offer manufacturers simplified customs procedures, operational flexibility, and a general environment of relaxed regulations.

Governmental Actions to Discourage Imports and Block Market Access

Measures such as tariffs, import controls, and a host of nontariff barriers are designed to limit the inward flow of goods. **Tariffs** can be thought of as the "three R's" of global business: rules, rate schedules (duties), and regulations of individual countries. Duties on individual products or services are listed in the schedule of rates (see Table 8-3). One expert on global trade defines **duties** as "taxes that punish individuals for making choices of which their governments disapprove."[5]

As noted in earlier chapters, a major U.S. objective in the Uruguay round of GATT negotiations was to improve market access for U.S. companies with major U.S. trading partners. When the round ended in December 1993, the United States had secured

Table 8-3

Examples of Trade Barriers

Country or Region	Tariff Barriers	NTBs
European Union	16.5% antidumping tariff on shoes from China, 10% on shoes from Vietnam	Quotas on Chinese textiles
China	Tariffs as high as 28% on foreign-made auto parts	

[5] Edward L. Hudgins, "Mercosur Gets a 'Not Guilty' on Trade Diversion," *The Wall Street Journal*, March 21, 1997, p. A19.

reductions or total elimination of tariffs on 11 categories of U.S. goods exported to the EU, Japan, five of the EFTA nations (Austria, Switzerland, Sweden, Finland, and Norway), New Zealand, South Korea, Hong Kong, and Singapore. The categories affected included equipment for the construction, agricultural, medical, and scientific industry sectors, as well as steel, beer, brown distilled spirits, pharmaceuticals, paper, pulp and printed matter, furniture, and toys. Most of the remaining tariffs were phased out over a five-year period. A key goal of the recent Doha round of trade talks is the reduction in agricultural tariffs, which currently average 12 percent in the United States, 31 percent in the EU, and 51 percent in Japan.

Developed under the auspices of the Customs Cooperation Council (now the World Customs Organization), the **Harmonized Tariff System (HTS)** went into effect in January 1989 and has since been adopted by the majority of trading nations. Under this system, importers and exporters have to determine the correct classification number for a given product or service that will cross borders. With the Harmonized Tariff Schedule B, the export classification number for any exported item is the same as the import classification number. Also, exporters must include the Harmonized Tariff Schedule B number on their export documents to facilitate customs clearance. Accuracy, especially in the eyes of customs officials, is essential. The U.S. Census Bureau compiles trade statistics from the HTS system. Any HTS with a value of less than $2,500 is not counted as a U.S. export. However, *all* imports, regardless of value, are counted.

In spite of the progress made in simplifying tariff procedures, administering a tariff is an enormous problem. People who work with imports and exports must familiarize themselves with the different classifications and use them accurately. Even a tariff schedule of several thousand items cannot clearly describe every product traded globally. The introduction of new products and new materials used in manufacturing processes creates new problems. Often, determining the duty rate on a particular article requires assessing how the item is used or determining its main component material. Two or more alternative classifications may have to be considered. A product's classification can make a substantial difference in the duty applied. For example, is a Chinese-made X-Men action figure a doll or a toy? For many years, dolls were subject to a 12 percent duty when imported into the United States; the rate was 6.8 percent for toys. Moreover, action figures that represent nonhuman creatures such as monsters or robots were categorized as toys and qualified for lower duties than human figures that the Customs Service classifies as dolls.

Ed Kostenski, president of Nationwide Equipment in Jacksonville, Florida, walks in front of some of his refurbished Caterpillar equipment. The U.S. Commerce Department encourages small and medium-sized businesses like Nationwide to export more. In 2004, Kostenski struck a deal to sell $1.37 million in construction equipment to west Africa. But the U.S. Export-Import Bank canceled Kostenski's deal, leaving him with an unsold excavator, grader, loader, vibrating compactor and two bulldozers. For the second time in four years, the U.S. Congress is trying to change the agency's small-business financing operations.

OPEN *to* discussion

Why Doesn't the United States Export More?

Many nations export up to 20 percent of their total production; the United States exports only about 10 percent. Businesses in smaller industrialized countries easily exhaust the potential of their home market and are forced to search internationally for expansion opportunities. Meanwhile, their U.S. counterparts appear to have fallen victim to one or more barriers to successful exporting. First, the limited ambition of many American business managers may result in complacency and a lack of export consciousness. A second barrier is lack of knowledge of market opportunities abroad or misperceptions about those markets. The perceived lack of necessary resources—managerial skill, time, financing, and productive capacity—is often a third barrier that prevents companies from pursuing export opportunities. Unrealistic fears are a fourth type of barrier to exporting. When weighing export expansion opportunities, managers may express concerns about operating difficulties, environmental differences, credit or other types of risks, and possible strains upon the company. A fifth type of barrier is management inertia—the simple inability of company personnel to overcome export myopia.

U.S. exports have historically been dominated by the large companies of the *Fortune* 500. By contrast, in Germany, small businesses are the export powerhouses. Studies have shown that, in the United States it is smaller-sized businesses rather than the *Fortune* 500 that are the major source of new jobs. Until recently, relatively few of these smaller companies were involved with exports. Dun & Bradstreet tracks U.S. exports in 70 industries; its figures now show that the majority of companies exporting employ less than 100 people. The U.S. Department of Commerce found that after participating in trade missions in 1987, 3,000 companies (most of which were small) generated $200 million in new export business—yet, the U.S. Small Business Administration estimates that there are tens of thousands of small companies that could export but do not. For many of these firms, exporting represents a major untapped market opportunity. To address this issue, in October 2001, the U.S. Commercial Service launched BuyUSA.com, a Web site that helps companies set up e-commerce operations to serve customers outside the United States.

A quick survey of the suggested readings at the end of this chapter highlights the fact that export activities at small and medium-sized enterprises (SMEs) is a popular research topic. For example, one recent study of 114 companies in California questioned the potential of standardized promotional messages in mass-produced government pamphlets to motivate managers at SMEs to investigate exporting. The researcher found that company personnel were more likely to be persuaded by arguments that stated exporting's benefits in microeconomic terms. Another recent study examined companies with previous export experience; the researchers examined the relationship between management's intention to continue exporting and the extent to which management valued the learning gained from export activities. The researchers determined that, in addition to meeting financial criteria, management at companies with export experience welcomed the opportunity to acquire new knowledge and new skills and to broaden organizational capabilities.

Sources: Tahi J. Gnepa, "Persuading Small Manufacturing Companies to Become Active Exporters: The Effect of Message Framing and Focus on Behavioral Intentions," Journal of Global Marketing 14, *no. 4 (2001), pp. 49–66; William J. Burpitt and Dennis A. Rondinelli, "Small Firms' Motivations for Exporting: To Earn and Learn?"* Journal of Small Business Management 38, *no. 4 (October 2000), pp. 1–14.*

Duties on both categories have been eliminated; however, the Toy Biz subsidiary of Marvel Enterprises spent nearly six years on an action in the U.S. Court of International Trade to prove that its X-Men action figures do not represent humans. Although the move appalled many fans of the mutant super heroes, Toy Biz hoped to be reimbursed for overpayment of past duties made when the U.S. Customs Service had classified imports of Wolverine and his fellow figures as dolls.[6]

A **nontariff barrier (NTB)** is any measure other than a tariff that is a deterrent or obstacle to the sale of products in a foreign market. Also known as *hidden trade barriers*, NTBs include quotas, discriminatory procurement policies, restrictive customs procedures, arbitrary monetary policies, and restrictive regulations.

A **quota** is a government-imposed limit or restriction on the number of units or the total value of a particular product or product category that can be imported. Generally, the quotas are designed to protect domestic producers. In 2005, for example, textile producers in Italy and other European countries were granted quotas on 10 categories of textile imports from China. The quotas, which are scheduled to run through the end of 2007, are designed to give European producers an opportunity to prepare for increased competition.[7]

Discriminatory procurement policies can take the form of government rules and administrative regulations specifying that local vendors or suppliers receive priority consideration. For example, the Buy American Act of 1933 stipulates that

[6] Neil King Jr., "Is Wolverine Human? A Judge Answers 'No'; Fans Howl in Protest," *The Wall Street Journal,* January 20, 2003, p. A1.

[7] Juliane von Reppert-Bismarck and Michael Carolan, "Quotas Squeeze European Boutiques," *The Wall Street Journal,* October 22, 2005, p. A9.

GLOBAL *marketing in action*

A Day in the Life of an Export Coordinator

Mikkel Jakobsen works as an export coordinator with Shipco Transport, a subsidiary of Scan-Group, a major European transportation company. Shipco Transport has offices all over the world, including 12 branches in North America. Shipco has an extensive network of independent agents in most areas of the world. Shipco's core business is Less than a Container Load (LCL) ocean freight, but also offers Full Container Load (FCL) ocean freight services, as well as airfreight. Mikkel and four other coworkers constitute the company's FCL Chicago branch export team. As a Non-Vessel Operating Common Carrier (NVOCC), Shipco Transport operates similarly to shipping companies such as Maersk Sealand, Mediterranean Shipping Company, and others, with one key difference: Shipco has no vessels of its own. Instead, Shipco relies on favorable contracts with over 40 carriers, enabling them to offer competitive rates on routings to destinations around the world. Most of Shipco's customers are freight forwarders, but the company also deals directly with exporting companies, and on occasion, private individuals. Because of its Midwest location, a significant number of containers come through Chicago on a daily basis and are railed to ports around the country.

In 2006, Mikkel earned a BA degree in international management and economics from a small liberal arts college in the Midwest. He is a citizen of Denmark, and currently works in the United States on a J-1 work visa, sponsored by Shipco Transport. How did he get his first job after graduating? Mikkel explains, "In the spring of 2006, I contacted 15 different companies operating in the United States that had a connection to Denmark. I was offered a position in Shipco Transport's Chicago branch."

Mikkel's day begins at 8:30 AM, and usually ends at 5:30 PM, depending on the workload. Most customers are located in the Midwest, but overnight, he receives e-mails from overseas that he processes in the morning hours. Mikkel says, "In general, my job consists of quoting out shipping costs to customers, placing bookings with steamship lines, preparing export documentation, and dealing with problems that arise during the container's journey from shipper to consignee."

"A customer contacts me with a rate request on a certain routing," Mikkel continues. "He may wish to ship one 20-foot container with auto parts from Indianola, to the port of Ningbo, China. Based on our carrier contracts, I work up a quote including drayage from Indianola, Iowa to an appropriate rail hub, rail transportation from hub to port, and ocean freight from U.S port to port of discharge Ningbo. Several things must be considered including what carrier is cheapest on the routing, differences in transit times, if the commodity is covered in the contract, and what profit level is appropriate. If the customer accepts the quote, the booking is placed with the steamship line, and a dispatch is sent to the chosen trucking company. Certain situations need additional attention. If the commodity is hazardous, the hazardous declaration must be approved by the steamship line. Also, certain goods, such as automobiles, must be cleared by customs before leaving the United States to avoid U.S customs demanding the return of the container for inspection, at the expense of the party at fault.

"Although quoting and setting up bookings takes up a lot of my work day, the majority is spent addressing various problems and issues that arise. Problems such as carriers running out of equipment at their depots, loadings taking longer than expected, or rail delays, are common and dealt with regularly. More serious issues are derailments, problems securing payment, and container abandonment. As an example, disposing of scrap materials in the United States can be expensive, and in the past, some have overcome the problem by loading it in a container, and sending it to places like India as a collect shipment with a nonexistent consignee. This can become an extremely costly situation as demurrage (storage charges), unloading and disposal charges may apply.

"In ocean freight, we work with ETD's (Estimated Time of Departure) and ETA's (Estimated Time of Arrival), because vessels crossing oceans tend to deviate from their schedule. Although this is a fact, customers sometimes have a difficult time understanding the concept. In the world of shipping, vessels running late, expected early, or even on time can be a problem. If so, I am contacted by my customer who either needs an explanation or appropriate action taken. As a middleman, I will contact the specific carrier with the same request. Most of the time, the problem is that the container hasn't reached its destination according to the ETA.

"Interestingly, sometimes a shipper is interested in a delay, and wants the container held up on its journey. This could be because more time is needed to secure payment, or it could represent an attempt to avoid a holiday in the destination country."

How did Mikkel's college studies prepare him for the job? "Incoterms, Letter of Credit, SED (Shippers Export Declaration), and B/L (Bill of Lading) are just some of the industry jargon used on a daily basis. Working with customers, familiarity is expected. The documentation part of export shipping is important, and demands attention to detail. As an NVOCC, Shipco produces both a House B/L and a Line B/L that holds information on the shipper and consignee, and on the products shipped. Most of our containers are released on an express release basis, but some require the use of original bills of lading. In these instances, the original B/L must be presented before a container is released. Although I do not get directly involved in the intricacies of L/C (Letter of Credit) shipments, special attention must be given to the accuracy of B/L information because small deviations can be troublesome. When doing business internationally it is essential to recognize the differences in how business is conducted around the world. South America and Russia in particular are destinations where we rely heavily on our overseas offices and agents and their knowledge of local customs and regulations."

Summing up, Mikkel says, "I enjoy operating on an international level on a daily basis, while doing my part to alleviate the current American trade deficit. Working in the transportation industry, I am sometimes surprised by how many different and obscure items are exported around the world. Although the process may seem overwhelming, with the help of a company such as Shipco that specializes in shipping, any company anywhere can view the entire world as a potential market."

U.S. federal agencies must buy articles produced in the United States unless domestically produced goods are not available, the cost is unreasonable, or purchasing U.S. materials would be inconsistent with the public interest. Similarly, the Fly American Act states that employees of the U.S. government must fly on domestic carriers whenever possible. Formal or informal company policies can also discriminate against foreign suppliers. In the automotive industry, the relatively low level of Japanese imports of U.S.-made auto parts is a contentious issue that centers on procurement policies.

Customs procedures are considered restrictive if they are administered in a way that makes compliance difficult and expensive. For example, the U.S. Department of Commerce might classify a product under a certain harmonized number; Canadian customs may disagree. The U.S. exporter may have to attend a hearing with Canadian customs officials to reach an agreement. Such delays cost time and money for both the importer and exporter.

Discriminatory exchange rate policies distort trade in much the same way as selective import duties and export subsidies. As noted earlier, some Western policy makers have argued that China is pursuing policies that ensure an artificially weak currency. Such a policy has the effect of giving Chinese goods a competitive price edge in world markets.

Finally, **restrictive administrative and technical regulations** also can create barriers to trade. These may take the form of antidumping regulations, product size regulations, and safety and health regulations. Some of these regulations are intended to keep out foreign goods; others are directed toward legitimate domestic objectives. For example, the safety and pollution regulations being developed in the United States for automobiles are motivated almost entirely by legitimate concerns about highway safety and pollution. However, an effect of these regulations has been to make it so expensive to comply with U.S. safety requirements that some automakers have withdrawn certain models from the market. Volkswagen, for example, was forced to stop selling diesel automobiles in the United States for several years.

As discussed in earlier chapters, there is a growing trend to remove all such restrictive trade barriers on a regional basis. The largest single effort was undertaken by the EU and resulted in creation of a single market starting January 1, 1993. The intent was to have one standard for all of Europe's industry sectors, including automobile safety, drug testing and certification, and food and product quality controls. The introduction of the euro has also facilitated trade and commerce.

Chennai (formerly Madras) is both the capital of Tamil Nadu and the automotive capital of India. These Hyundai autos are awaiting export from Chennai; Daewoo, Fiat, Ford, GM, Honda, Mitsubishi, and Peugeot are among the global auto makers that also have operations in India. India's Automotive Mission Plan calls for sales in the sector to grow 16 percent annually. The Ministry of Heavy Industry expects vehicle sales will quadruple over the next decade, reaching $145 billion. By that time, the automotive industry will employ as many as 25 million people.

TARIFF SYSTEMS

Tariff systems provide either a single rate of duty for each item applicable to all countries or two or more rates, applicable to different countries or groups of countries. Tariffs are usually grouped into two classifications.

The **single-column tariff** is the simplest type of tariff; a schedule of duties in which the rate applies to imports from all countries on the same basis. Under the **two-column tariff** (Table 8-4), Column 1 includes "general" duties plus "special" duties indicating reduced rates determined by tariff negotiations with other countries. Rates agreed upon by "convention" are extended to all countries that qualify for **normal trade relations (NTR**; formerly most-favored nation or MFN) status within the framework of the WTO. Under the WTO, nations agree to apply their most favorable tariff or lowest tariff rate to all nations—subject to some exceptions—that are signatories to the WTO. Column 2 shows rates for countries that do not enjoy NTR status.

Table 8-5 shows a detailed entry from Chapter 89 of the HTS pertaining to "Ships, Boats, and Floating Structures" (for explanatory purposes, each column has been identified with an alphabet letter). Column A contains the heading level numbers that uniquely identify each product. For example, the product entry for heading level 8903 is "yachts and other vessels for pleasure or sports; row boats and canoes." Subheading level 8903.10 identifies "inflatable"; 8903.91 designates "sailboats with or without auxiliary motor." These six-digit numbers are used by more than 100 countries that have signed on to the HTS. Entries can extend to as many as 10 digits, with the last four used on a country-specific basis for each nation's individual tariff and data collection purposes. Taken together, E and F correspond to Column 1 as shown in Table 8-5, while G corresponds to Column 2.

The United States has given NTR status to some 180 countries around the world, so the name is really a misnomer. Only North Korea, Iran, Cuba, and Libya are excluded, showing that NTR is really a political tool more than an economic one. In the past, China had been threatened with the loss of NTR status because of alleged human rights violations. The landed prices of its products would have risen significantly, which would have priced many Chinese products out of the U.S. market. The U.S. Congress granted China permanent NTR as a precursor to its joining the WTO in 2001. Table 8-6 illustrates what a loss of NTR status would have meant to China.

A **preferential tariff** is a reduced tariff rate applied to imports from certain countries. GATT prohibits the use of preferential tariffs, with three major exceptions. First are historical preference arrangements such as the British Commonwealth preferences and similar arrangements that existed before GATT. Second, preference schemes that are part of a formal economic integration treaty, such as free trade areas or common markets, are excluded. Third, industrial countries are permitted to grant preferential market access to companies based in less-developed countries.

Table 8-4

Sample Rates of Duty for U.S. Imports

Column 1		Column 2
General	Special	Non-NTR
1.5%	Free (A, E, IL, J, MX) 0.4% (CA)	30%

A, Generalized System of Preferences
E, Caribbean Basin Initiative (CBI) Preference
IL, Israel Free Trade Agreement (FTA) Preference
J, Andean Agreement Preference
MX, NAFTA Canada Preference
CA, NAFTA Mexico Preference

Table 8-5

Chapter 89 of the Harmonized System

A	B	C	D	E	F	G
8903		Yachts and other vessels for pleasure or sports; row boats and canoes				
8903.10.00		Inflatable		2.4%	Free (A,E,IL,J,MX)[a] 0.4% (CA)	
		Valued over $500				
	15	With attached rigid hull	No			
	45	Other..	No			
	60	Other..	No			
8903.91.00		Other: Sailboats, with or without auxiliary motors		1.5%	Free (A,E,IL,J,MX) 0.3% (CA)	

A, Generalized System of Preferences
E, Caribbean Basin Initiative (CBI) Preference
IL, Israel Free Trade Agreement (FTA) Preference
J, Andean Agreement Preference
MX, NAFTA Canada Preference
CA, NAFTA Mexico Preference

The United States is now a signatory to the GATT customs valuation code. U.S. customs value law was amended in 1980 to conform to the GATT valuation standards. Under the code, the primary basis of customs valuation is "transaction value." As the name implies, **transaction value** is defined as the actual individual transaction price paid by the buyer to the seller of the goods being valued. In instances where the buyer and seller are related parties (e.g., when Honda's U.S. manufacturing subsidiaries purchase parts from Japan), customs authorities have the right to scrutinize the transfer price to make sure it is a fair reflection of market value. If there is no established transaction value for the good, alternative methods that are used to compute the customs value sometimes result in increased values and, consequently, increased duties. In the late 1980s, the U.S. Treasury Department began a major investigation into the transfer prices charged by the Japanese automakers to their U.S. subsidiaries. It charged that the Japanese paid virtually no U.S. income taxes because of their "losses" on the millions of cars they import into the United States each year.

During the Uruguay round of GATT negotiations, the United States successfully sought a number of amendments to the Agreement on Customs Valuations. Most important, the United States wanted clarification of the rights and obligations of importing and exporting countries in cases where fraud was suspected. Two overall categories of products were frequently targeted for investigation. The first included exports of textiles, cosmetics, and consumer durables; the second included entertainment software such as videotapes, audiotapes, and compact

Table 8-6

Tariff Rates for China, NTR Versus Non-NTR

	NTR	Non-NTR
Gold jewelry, such as plated neck chains	6.5%	80%
Screws, lock washers, misc. iron/steel parts	5.8%	35%
Steel products	0–5%	66%
Rubber footwear	0	66%
Women's overcoats	19%	35%

Source: U.S. Customs Service

disks. Such amendments improve the ability of U.S. exporters to defend their interests if charged with fraudulent practices. The amendments were also designed to encourage nonsignatories, especially developing countries, to become parties to the agreement.

Customs Duties

Customs duties are divided into two categories. They may be calculated either as a percentage of the value of the goods (ad valorem duty), as a specific amount per unit (specific duty), or as a combination of both of these methods. Before World War II, specific duties were widely used, and the tariffs of many countries, particularly those in Europe and Latin America, were extremely complex. During the past half century, the trend has been toward the conversion to ad valorem duties.

An **ad valorem duty** is expressed as a percentage of the value of goods. The definition of customs value varies from country to country. An exporter is well advised to secure information about the valuation practices applied to his or her product in the country of destination. The reason is simple: to be price competitive with local producers. In countries adhering to GATT conventions on customs valuation, the customs value is landed cost, insurance, and freight (CIF) amount at the port of importation. This cost should reflect the arm's-length price of the goods at the time the duty becomes payable.

A **specific duty** is expressed as a specific amount of currency per unit of weight, volume, length, or other units of measurement; for example, "US$0.50 per pound," "US$1.00 per pair," or "US$0.25 per square yard." Specific duties are usually expressed in the currency of the importing country, but there are exceptions, particularly in countries that have experienced sustained inflation.

Both ad valorem and specific duties are occasionally set out in the custom tariff for a given product. Normally, the applicable rate is the one that yields the higher amount of duty, although there are cases where the lower is specified. Compound or mixed duties provide for specific, plus ad valorem, rates to be levied on the same articles.

Other Duties and Import Charges

Dumping, which is the sale of merchandise in export markets at unfair prices, is discussed in detail in Chapter 11. To offset the impact of dumping and to penalize guilty companies, most countries have introduced legislation providing for the imposition of **antidumping duties** if injury is caused to domestic producers. Such duties take the form of special additional import charges equal to the dumping margin. Antidumping duties are almost invariably applied to products that are also manufactured or grown in the importing country. In the United States, antidumping duties are assessed after the commerce department finds a foreign company guilty of dumping and the International Trade Commission rules that the dumped products injured American companies.

Countervailing duties (CVDs) are additional duties levied to offset subsidies granted in the exporting country. In the United States, countervailing duty legislation and procedures are very similar to those pertaining to dumping. The U.S. Commerce Department and the International Trade Commission jointly administer both the countervailing duty and antidumping laws under provisions of the Trade and Tariff Act of 1984. Subsidies and countervailing measures received a great deal of attention during the Uruguay GATT negotiations. In 2001, the ITC and commerce department imposed both countervailing and antidumping duties on Canadian lumber producers. The CVDs were intended to offset subsidies to Canadian sawmills in the form of low fees for cutting trees in forests owned by the Canadian government. The antidumping duties on imports of softwood lumber, flooring, and siding were in response to complaints by American producers that the Canadians were exporting lumber at prices below their production cost.

Several countries, including Sweden and some other members of the EU, apply a system of **variable import levies** to certain categories of imported agricultural products. If prices of imported products would undercut those of domestic products, the effect of these levies is to raise the price of imported products to the domestic price level. **Temporary surcharges** have been introduced from time to time by certain countries, such as the United Kingdom and the United States, to provide additional protection for local industry and, in particular, in response to balance-of-payments deficits.

KEY EXPORT PARTICIPANTS

Anyone with responsibilities for exporting should be familiar with some of the entities that can assist with various export-related tasks. Some of these entities, including purchasing agents, export brokers, and export merchants, have no assignment of responsibility from the client. Others, including export management companies, manufacturers' export representatives, export distributors, and freight forwarders, are assigned responsibilities by the exporter.

Foreign purchasing agents are variously referred to as *buyer for export*, *export commission house*, or *export confirming house*. They operate on behalf of, and are compensated by, an overseas customer known as a "principal." They generally seek out the manufacturer whose price and quality match the specifications of their principal. Foreign purchasing agents often represent governments, utilities, railroads, and other large users of materials. Foreign purchasing agents do not offer the manufacturer or exporter stable volume except when long-term supply contracts are agreed upon. Purchases may be completed as domestic transactions with the purchasing agent handling all export packing and shipping details, or the agent may rely on the manufacturer to handle the shipping arrangements.

The **export broker** receives a fee for bringing together the seller and the overseas buyer. The fee is usually paid by the seller, but sometimes the buyer pays it. The broker takes no title to the goods and assumes no financial responsibility. A broker usually specializes in a specific commodity, such as grain or cotton, and is less frequently involved in the export of manufactured goods.

Export merchants are sometimes referred to as *jobbers*. These are marketing intermediaries that identify market opportunities in one country or region and make purchases in other countries to fill these needs. An export merchant typically buys unbranded products directly from the producer or manufacturer. The export merchant then brands the goods and performs all other marketing activities, including distribution. For example, an export merchant might identify a good source of women's boots in a factory in China. The merchant then purchases a large quantity of the boots and markets them in, for example, the EU or the United States.

Export management company (EMC) is the term used to designate an independent marketing intermediary that acts as the export department for two or more manufacturers ("principals") whose product lines do not compete with each other. The EMC usually operates in the name of its principals for export markets, but it may operate in its own name. It may act as an independent distributor, purchasing and reselling goods at an established price or profit margin. Alternatively, it may act as a commission representative, taking no title and bearing no financial risks in the sale. According to one recent survey of U.S.-based EMCs, the most important activities for export success are gathering marketing information, communication with markets, setting prices, and ensuring parts availability. The same survey ranked export activities in terms of degree of difficulty; analyzing political risk, sales force management, setting pricing, and obtaining financial information were found to be the most difficult to accomplish. One of the study's conclusions was that the U.S. government should do a better job of helping EMCs and their clients analyze the political risk associated with foreign markets.[8]

Another type of intermediary is the **manufacturer's export agent (MEA)**. Much like an EMC, the MEA can act as an export distributor or as export commission representative. However, the MEA does not perform the functions of an export department and the scope of market activities is usually limited to a few countries. An **export distributor** assumes financial risk. The export distributor usually represents several manufacturers and is, therefore, sometimes known as a *combination export manager*. The firm usually has the exclusive right to sell a manufacturer's products in all or some markets outside the country of origin. The distributor pays for the goods and assumes all financial risks associated with the foreign sale; it handles all shipping details. The agent ordinarily sells at the manufacturer's list price abroad; compensation comes in the form of an agreed percentage of list price. The distributor may operate in its own name or in the manufacturer's.

The **export commission representative** assumes no financial risk. The manufacturer assigns all or some foreign markets to the commission representative. The manufacturer carries all accounts, although the representative often provides credit checks and arranges financing. Like the export distributor, the export commission representative handles several accounts and is also known as a combination export management company.

The **cooperative exporter**, sometimes called a *mother hen*, *piggyback exporter*, or *export vendor*, is an export organization of a manufacturing company retained by other independent manufacturers to sell their products foreign markets. Cooperative exporters usually operate as export distributors for other manufacturers, but in special cases they operate as export commission representatives. They are regarded as a form of export management company.

Freight forwarders are licensed specialists in traffic operations, customs clearance, and shipping tariffs and schedules; simply put, they can be thought of as travel agents for freight. Minnesota-based C.H. Robinson Worldwide is one such company. Freight forwarders seek out the best routing and the best prices for transporting freight and assist exporters in determining and paying fees and insurance charges. Forwarders may also do export packing, when necessary. They usually handle freight from port of export to overseas port of import. They may also move inland freight from factory to port of export and, through affiliates abroad, handle freight from port of import to customer. Freight forwarders also perform consolidation services for land, air, and ocean freight. Because they contract for large blocks of space on a ship or airplane, they can resell that space to various shippers at a rate lower than is generally available to individual shippers dealing directly with the export carrier.

A licensed forwarder receives brokerage fees or rebates from shipping companies for booked space. Some companies and manufacturers engage in freight forwarding or some phase of it on their own, but they may not, under law, receive brokerage from shipping lines.

8 Donald G. Howard, "The Role of Export Management Companies in Global Marketing," *Journal of Global Marketing* 8, no. 1 (1994), pp. 95–110.

U.S. customs agents on the job in Texas. Beginning exporters can utilize the services of freight forwarders, export management companies, and other firms that specialize in moving goods across borders.

ORGANIZING FOR EXPORTING IN THE MANUFACTURER'S COUNTRY

Home-country issues involve deciding whether to assign export responsibility inside the company or to work with an external organization specializing in a product or geographic area. Most companies handle export operations within their own in-house export organization. Depending on the company's size, responsibilities may be incorporated into an employee's domestic job description. Alternatively, these responsibilities may be handled as part of a separate division or organizational structure.

The possible arrangements for handling exports include the following:

1. As a part-time activity performed by domestic employees.
2. Through an export partner affiliated with the domestic marketing structure that takes possession of the goods before they leave the country.
3. Through an export department that is independent of the domestic marketing structure.
4. Through an export department within an international division.
5. For multidivisional companies, each of the preceding options is available.

A company that assigns a sufficiently high priority to its export business will establish an in-house organization. It then faces the question of how to organize effectively. This depends on two things: the company's appraisal of the opportunities in export marketing and its strategy for allocating resources to markets on a global basis. It may be possible for a company to make export responsibility part of a domestic employee's job description. The advantage of this arrangement is obvious: It is a low-cost arrangement requiring no additional personnel. However, this approach can work under only two conditions: First, the domestic employee assigned to the task must be thoroughly competent in terms of product and customer knowledge; second, that competence must be applicable to the target international market(s). The key issue underlying the second condition is the extent to which the target export market is different from the domestic market. If customer circumstances and characteristics are similar, the requirements for specialized regional knowledge are reduced.

The company that chooses not to perform its own marketing and promotion in-house has numerous external export service providers from which to choose. As described previously, these include export trading companies (ETCs), EMCs, export merchants, export brokers, combination export managers, manufacturers' export representatives or commission agents, and export distributors. However, because these terms and labels may be used inconsistently, we urge the reader to check and confirm the services performed by a particular independent export organization.

ORGANIZING FOR EXPORTING IN THE MARKET COUNTRY

In addition to deciding whether to rely on in-house or external export specialists in the home country, a company must also make arrangements to distribute the product in the target market country. Every exporting organization faces one basic decision: To what extent do we rely on direct market representation as opposed to representation by independent intermediaries?

There are two major advantages to direct representation in a market: control and communications. Direct market representation allows decisions concerning program development, resource allocation, or price changes to be implemented unilaterally. Moreover, when a product is not yet established in a market, special efforts are necessary to achieve sales. The advantage of direct representation is that the marketer's investment ensures these special efforts. With indirect or independent representation, such efforts and investment are often not forthcoming; in many cases, there is simply not enough incentive for independents to invest significant time and money in representing a product. The other great advantage to direct representation is that the possibilities for feedback and information from the market are much greater. This information can vastly improve export marketing decisions concerning product, price, communications, and distribution.

Direct representation does not mean that the exporter is selling directly to the consumer or customer. In most cases, direct representation involves selling to wholesalers or retailers. For example, the major automobile exporters in Germany and Japan rely upon direct representation in the U.S. market in the form of their distributing agencies, which are owned and controlled by the manufacturing organization. The distributing agencies sell products to franchised dealers.

In smaller markets, it is usually not feasible to establish direct representation because the low sales volume does not justify the cost. Even in larger markets, a small manufacturer usually lacks adequate sales volume to justify the cost of direct representation. Whenever sales volume is small, use of an independent distributor is an effective method of sales distribution. Finding "good" distributors can be the key to export success.

EXPORT FINANCING AND METHODS OF PAYMENT

The appropriate method of payment for a given international sale is a basic credit decision. A number of factors must be considered, including currency availability in the buyer's country, creditworthiness of the buyer, and the seller's relationship to the buyer. Finance managers at companies that have never exported often express concern regarding payment. Many CFOs with international experience know that there are generally fewer collections problems on international sales than on domestic sales, provided the proper financial instruments are used. The reason is simple: A letter of credit can be used to guarantee payment for a product.

The export sale begins when the exporter-seller and the importer-buyer agree to do business. The agreement is formalized when the terms of the deal are set down in a pro forma invoice, contract, fax, or some other document. Among other things, the **pro forma invoice** spells out how much, and by what means, the exporter-seller wants to be paid.

Documentary Credit

Documentary credits (also known as letters of credit) are widely used as a payment method in international trade. A **letter of credit (L/C)** is essentially a document stating that a bank has substituted its creditworthiness for that of the importer-buyer. Next to cash in advance, an L/C offers the exporter the best assurance of being paid. That assurance arises from the fact that the payment obligation under an L/C lies with the buyer's bank and not with the buyer. The international standard by which L/Cs are interpreted is ICC Publication No. 500 of the Uniform Customs and Practice for Documentary Credits, also known as UCP 500.

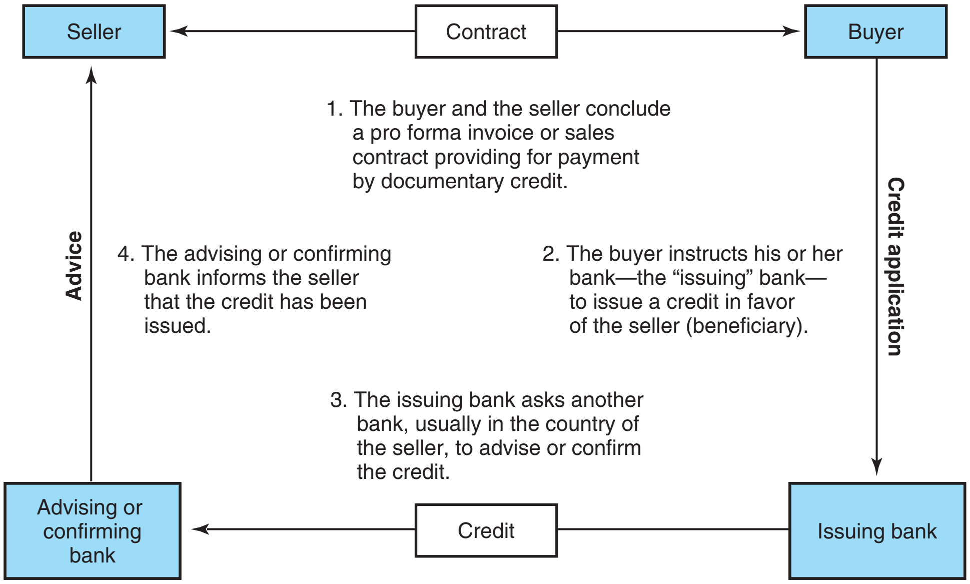
The importer-buyer's bank is the "issuing" bank; the importer-buyer is, in essence, asking the issuing bank to extend credit. The importer-buyer is considered the applicant. The issuing bank may require that the importer-buyer deposit funds in the bank or use some other method to secure a line of credit. After agreeing to extend the credit, the issuing bank requests that the exporter-seller's bank advise or confirm the L/C. (A bank "confirms" an L/C by adding its name to the document.) The seller's bank becomes the "advising" or "confirming" bank. Whether it is advised or confirmed, the L/C represents a guarantee that assures payment contingent on the exporter-seller's (the beneficiary in the transaction) complying with the terms set forth in the L/C.

The actual payment process is set in motion when the exporter-seller physically ships the goods and submits the necessary documents as requested in the L/C. These could include a transportation bill of lading (which may represent title to the product), a commercial invoice, a packing list, a certificate of origin, or insurance certificates. For most of the world, a commercial invoice and bill of lading represent the minimum documentation required for customs clearance. If the pro forma invoice specifies a confirmed L/C as the method of payment, the exporter-seller receives payment at the time the correct shipping documents are presented to the confirming bank. The confirming bank, in turn, requests payment from the issuing bank. In the case of an irrevocable L/C, the exporter-seller receives payment only after the advising bank negotiates the documents and requests payment from the issuing bank in accordance with terms set forth in the L/C. Once the shipper sends the documents to the advising bank, the advising bank negotiates those documents and is referred to as the negotiating bank. Specifically, it takes each shipping document and closely compares it to the L/C. If there are no discrepancies, the negotiating or confirming bank transfers the money to the exporter-seller's account.

The fee for an irrevocable L/C—for example, "1/8 of 1 percent of the value of the credit, with an $80 minimum"—is lower than that for a confirmed L/C. The higher bank fees associated with confirmation can drive up the final cost of the sale; fees are also higher when the transaction involves a country with a high level of risk. Good communication between the exporter-seller and the advising or confirming bank regarding fees is important; the selling price indicated on the pro forma invoice should reflect these and other costs associated with exporting. The process described here is illustrated in Figures 8-1 and 8-2.

Figure 8-1

Flowchart of a Documentary Credit

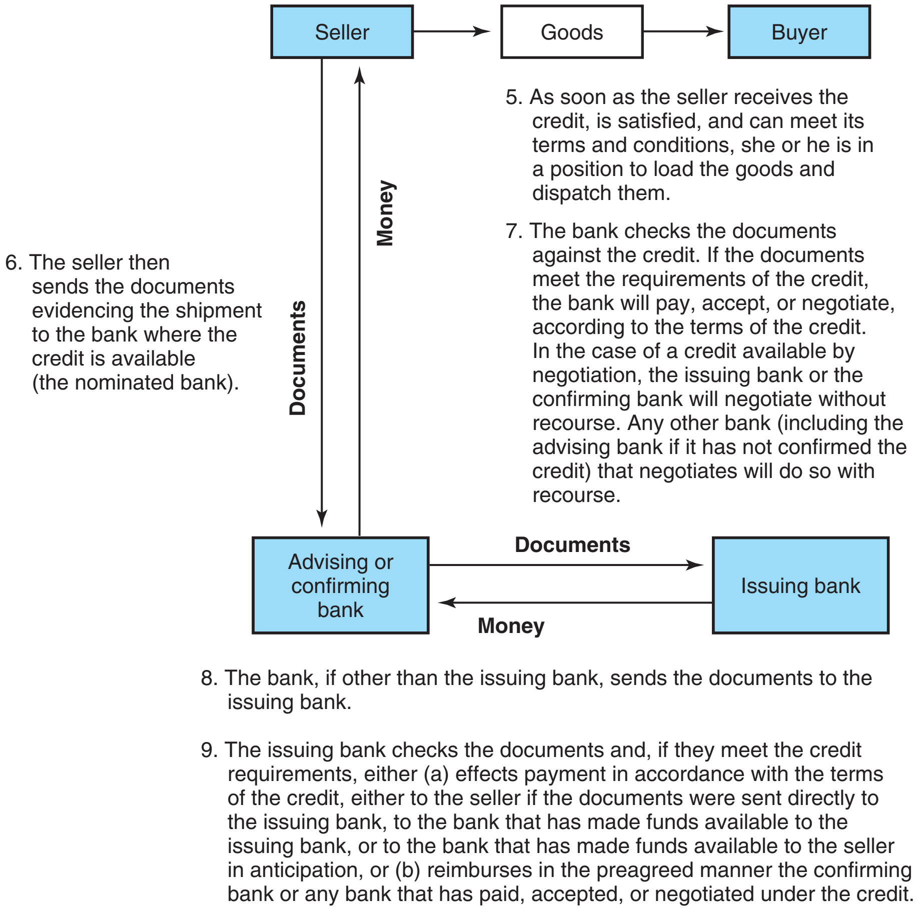


Documentary Collections (Sight or Time Drafts)

After an exporter and an importer have established a good working relationship and the finance manager's level of confidence increases, it may be possible to move to a documentary collection or open-account method of payment. A documentary collection is a method of payment that uses a bill of exchange, also known as a *draft*. A **bill of exchange** is a negotiable instrument that is easily

Figure 8-2

Flowchart of Documentary Credit Documents



transferable from one party to another. In its simplest form, it is a written order from one party (the *drawer*) directing a second party (the *drawee*) to pay to the order of a third party (the *payee*). Drafts are distinctly different from L/Cs; a **draft** is a payment instrument that transfers all the risk of nonpayment onto the exporter-seller. Banks are involved as intermediaries but they do not bear financial risk. Because a draft is negotiable, however, a bank may be willing to buy the draft from the seller at a discount and assume the risk. Also, because bank fees for drafts are lower than those for L/Cs, drafts are frequently used when the monetary value of an export transaction is relatively low.

With a documentary draft, the exporter delivers documents such as the bill of lading, the commercial invoice, a certificate of origin, and an insurance certificate to a bank in the exporter's country. The shipper or bank prepares a collection letter (draft) and sends it via courier to a correspondent bank in the importer-buyer's country. The draft is presented to the importer; payment takes place in accordance with the terms specified in the draft. In the case of a *sight draft* (also known as *documents against payment* or D/P), the importer-buyer is required in principle to make payment when presented with both the draft and the shipping documents, even though the buyer may not have taken possession of the goods yet. *Time drafts* can take two forms. As the name implies, an *arrival draft* specifies that payment is due when the importer-buyer receives the goods; a *date draft* requires payment on a particular date, irrespective of whether the importer has the goods in hand.

Cash in Advance

A number of conditions may prompt the exporter to request cash payment—in whole or in part—in advance of shipment. Examples include times when credit risks abroad are high, when exchange restrictions within the country of destination may delay return of funds for an unreasonable period, or when, for any other reason, the exporter may be unwilling to sell on credit terms. Because of competition and restrictions against cash payment in many countries, the volume of business handled on a cash-in-advance basis is small. A company that manufactures a unique product for which there are no substitutes available can also use cash in advance. For example, Compressor Control Corporation is a Midwestern firm that manufactures special equipment for the oil industry. It can stipulate cash in advance because no other company offers a competing product.

Sales on Open Account

Goods that are sold on open account are paid for after delivery. Intracorporate sales to branches or subsidiaries of an exporter are frequently on open-account terms. Open-account terms also generally prevail in areas where exchange controls are minimal and exporters have had long-standing relations with good buyers in nearby or long-established markets. For example, Jimmy Fand is the owner of the Tile Connection in Tampa, Florida. He imports high-quality ceramic tile from Italy, Spain, Portugal, Colombia, Brazil, and other countries. Fand takes pride in the excellent credit rating that he has built up with his vendors. The manufacturers from whom he buys no longer require an L/C; Fand's philosophy is "pay in time," and he makes sure that his payables are sent electronically on the day they are due.

The main objection to open-account sales is the absence of a tangible obligation. Normally, if a time draft is drawn and then dishonored after acceptance, it can be used as a basis of legal action. By contrast, if an open-account transaction is dishonored, the legal procedure may be more complicated. Starting in 1995, the Export-Import Bank expanded insurance coverage on open-account transactions to limit the risk for exporters.

ADDITIONAL EXPORT AND IMPORT ISSUES

In the post-September 11 business environment in the United States, imports have come under increased scrutiny as an issue of national security. A number of initiatives have been launched to ensure that international cargo cannot be used for terrorism. On such initiative is the **Customs Trade Partnership Against Terrorism (C-TPAT)**. As noted on the U.S. Customs and Border Protection Web site:

> C-TPAT recognizes that U.S. Customs and Border Protection (CBP) can provide the highest level of cargo security only through close cooperation with the ultimate owners of the international supply chain such as importers, carriers, consolidators, licensed customs brokers, and manufacturers. Through this initiative, CBP is asking businesses to ensure the integrity of their security practices and communicate and verify the security guidelines of their business partners within the supply chain.

CBP is responsible for screening import cargo transactions; the goal of C-TPAT is to secure voluntary cooperation of supply chain participants in an effort to reduce inspection delays. Organizations that have achieved certified C-TPAT status are entitled to priority status for CBP inspections.

Another issue is **duty drawback**. This refers to refunds of duties paid on imports that are processed or incorporated into other goods and then reexported. Drawbacks have long been used in the United States to encourage exports. However, when NAFTA was negotiated, the United States Trade Representative agreed to restrict drawbacks on exports to Canada and Mexico. As the United States negotiates new trade agreements, some industry groups are lobbying in favor of keeping drawbacks.[9] Duty drawbacks are also common in protected economies and represent a policy instrument that aids exporters by reducing the price of imported production inputs. China was required to remove duty drawbacks as a condition for joining the WTO. As duty rates around the world fall, the drawback issue will become less important.

SOURCING

In global marketing, the issue of customer value is inextricably tied to the **sourcing decision**: whether a company makes or buys its products as well as where it makes or buys its products. **Outsourcing** means shifting production jobs or work assignments to another company to cut costs. When the outsourced work moves to another country, the terms *global outsourcing* or *offshoring* are sometimes used. In today's competitive marketplace, companies are under intense pressure to lower costs; one way to do this is to locate manufacturing and other activities in China, India, and other low-wage countries. And why not? Many consumers do not know where the products they buy—sneakers, for example—are manufactured. It is also true that, as the quiz in Chapter 1 indicated, people often can't match corporate and brand names with particular countries. In theory, this situation bestows great flexibility on companies. However, in the United States, the sourcing issue became highly politicized during the 2004 presidential campaign. Several Democratic candidates tapped into Americans' fears and concerns over a "jobless" economic recovery. The first wave of nonmanufacturing outsourcing primarily affected **call centers**. These are sophisticated telephone operations that provide customer support and other services to inbound callers from around the world. Call centers also perform outbound services such as telemarketing. Now, however, outsourcing is expanding and includes white-collar, high-tech service sector jobs. Workers in low-wage countries are performing a variety of tasks,

[9] R. G. Edmonson, "Drawback Under Attack at USTR," *The Journal of Commerce*, August 11–17, 2003, p. 21.

In Bangalore, India, and other locations, call centers such as this one specialize in "long-distance" or "arm's length" services. India's well-educated workforce and the growing availability of broadband Internet connections mean that more Western service jobs and industries are subject to global outsourcing. Among the tasks being outsourced to India are medical record transcription, tax return preparation, and technical writing. The book you are reading was typeset in Jawahar Nagar, Pondicherry, India.

including completing tax returns, performing research for financial services companies, reading medical CAT scans and X-rays, and drawing up architectural blueprints. American companies that transfer work abroad are finding themselves in the spotlight.

As this discussion suggests, the decision of where to locate key business activities depends on other factors besides cost. There are no simple rules to guide sourcing decisions, and, the sourcing decision is one of the most complex and important decisions faced by a global company. Several factors may figure in the

global MARKETING Q&A

USA Today: "Offshoring is a polarizing issue. One survey says 16 percent of Americans agree that it's good for the U.S. economy. If the masses are wrong, why?"

Uwe Doerken, Former Executive Chairman, DHL: "Offshoring first of all benefits the consumer. More efficient and less costly production leads to more affordable products and services and allows companies in higher-labor-cost economies like the USA or Europe to stay competitive and preserve their remaining jobs."

USA Today: "To many, it doesn't seem to be working. Good-paying technology jobs are moving to India. Exporting unskilled jobs was one thing. What about offshoring skilled jobs?"

Uwe Doerken: "Skilled and unskilled are not absolute. Economies move up the skill curve continuously, and what was a high-skill job yesterday may have become a medium skill today and low skill tomorrow. Sewing mass-market clothing was high-tech in England in the nineteenth century and a major industry in developed countries until the 1970s. It has migrated mostly to India, China, and other Asian economies. For the USA, it's about staying ahead of the game by always adapting and keeping the highest value-added jobs in the country."

Source: Ron Insana, "Executive Suite: 'Offshoring . . . Benefits the Consumer' " USA Today, *January 17, 2005, p. 6B.*

sourcing decision: management vision, factor costs and conditions, customer needs, public opinion, logistics, country infrastructure, political factors, and exchange rates.

Management Vision

Some chief executives are determined to retain some or all manufacturing in their home country. Nicolas Hayek, head of the Swatch Group, is one such executive. Hayek presided over the spectacular revitalization of the Swiss watch industry. The Swatch Group's portfolio of brands includes Blancpain, Omega, Breguet, Rado, and, the inexpensive Swatch brand. Hayek demonstrated that the fantasy and imagination of childhood and youth can be translated into breakthroughs that allow mass-market products to be manufactured in high-wage countries side-by-side with handcrafted luxury products. The Swatch story is a triumph of engineering, as well as a triumph of the imagination. Similarly, top management at Canon has chosen to maintain a strategic focus on high value-added products rather than manufacturing location. The company aims to keep 60 percent of its manufacturing at home in Japan. The company offers a full line of office equipment, including popular products such printers and copiers; it is also one of the top producers of digital cameras. Instead of increasing the level of automation in its Japanese factories, it has converted from assembly lines to so-called cell production.[10]

Factor Costs and Conditions

Factor costs are land, labor, and capital costs (remember Economics 101). Labor includes the cost of workers at every level: manufacturing and production, professional and technical, and management. Basic manufacturing direct labor costs today range from less than $1 per hour in the typical emerging country to $6 to $12 per hour in the typical developed country. In certain industries in the United States, direct labor costs in manufacturing exceed $20 per hour without benefits. German hourly compensation costs for production workers in manufacturing are 160 percent of those in the United States while

[10] Sebastian Moffett, "Canon Manufacturing Strategy Pays Off with Strong Earnings," *The Wall Street Journal,* January 4, 2004, p. B3.

those in Mexico are only 15 percent of those in the United States. For Volkswagen, the wage differential between Mexico and Germany, combined with the strength of the mark and, most recently, the euro, dictate a Mexican manufacturing facility that builds Golf and Jetta models destined for the United States. The company's new Touareg SUV is assembled in Bratislava, Slovakia. Do lower wage rates demand that a company relocate 100 percent of its manufacturing to low-wage countries? Not necessarily. During his tenure as chairman at VW, Ferdinand Piech improved his company's competitiveness by convincing unions to accept flexible work schedules. For example, during peak demand, employees work six-day weeks; when demand slows, factories produce cars only three days per week.

Labor costs in nonmanufacturing jobs are also dramatically lower in some parts of the world. For example, a software engineer in India may receive an annual salary of $12,000; by contrast, an American with the same educational credentials might earn $80,000.

The other factors of production are land, materials, and capital. The cost of these factors depends upon their availability and relative abundance. Often, the differences in factor costs will offset each other so that, on balance, companies have a level field in the competitive arena. For example, some countries have abundant land and Japan has abundant capital. These advantages partially offset each other. When this is the case, the critical factor is management, professional, and worker team effectiveness.

The application of advanced computer controls and other new manufacturing technologies has reduced the proportion of labor relative to capital for many businesses. In formulating a sourcing strategy, company managers and executives should also recognize the declining importance of direct manufacturing labor as a percentage of total product cost. It is certainly true that, for many companies in high-wage countries, the availability of cheap labor is a prime consideration when choosing manufacturing locations; this is why China has become "the world's workplace." However, it is also true that direct labor cost may be a relatively small percentage of the total production cost. As a result, it may not be worthwhile to incur the costs and risks of establishing a manufacturing activity in a distant location. For example, Greg Petsch, senior vice president of manufacturing at Compaq, had to decide whether to close plants in Houston and Scotland and contract out assembly work to the Far East. After determining that the human labor content in a PC is only about 15 minutes, he opted to run Compaq's existing Houston factory 24 hours a day. Another decision was whether to source motherboards from a vendor in Asia. Petsch calculated that Compaq could produce the boards—which account for 40 percent of the cost of a PC—for $25 less than suppliers in the Far East. Manufacturing in Houston also saved two weeks in shipping time, which translated into inventory savings.[11]

Customer Needs

Although outsourcing can help reduce costs, sometimes customers are seeking something besides the lowest possible price. Dell Computer recently rerouted some of its call center jobs back to the United States after complaints from key business customers that Indian tech support workers were offering scripted responses and having difficulty answering complex problems. In such instances, the need to keep customers satisfied justifies the higher cost of home-country support operations.

[11] Doron P. Levin, "Compaq Storms the PC Heights from Its Factory Floor," *The New York Times,* November 4, 1994, Section 3, p. 5.

Logistics

In general, the greater the distance between the product source and the target market, the greater the time delay for delivery and the higher the transportation cost. However, innovation and new transportation technologies are cutting both time and dollar costs. To facilitate global delivery, transportation companies such as CSX Corporation are forming alliances and becoming an important part of industry value systems. Manufacturers can take advantage of intermodal services that allow containers to be transferred among rail, boat, air, and truck carriers. In Europe, Latin America, and elsewhere, the trend toward regional economic integration means fewer border controls, which greatly speeds up delivery times and lowers costs.

"Supply Chain 101 says the most important thing is continuity of supply. When you establish a supply line that is 12,000 miles long, you have to weigh the costs of additional inventory and logistics costs versus what you can save in terms of lower costs per unit or labor costs."[12]

Norbert Ore, Institute for Supply Management

Despite these overall trends, a number of specific issues pertaining to logistics can affect the sourcing decision. For example, in the wake of the 2001 terror attacks, importers are required to send electronic lists to the U.S. government prior to shipping. The goal is to help the U.S. Customs Service identify high-risk cargo that could be linked to the global terror network. In fall 2002, a 10-day strike on the West Coast shut down 29 docks and cost the U.S. economy an estimated $20 billion. Such incidents can delay shipments by weeks or even months.

Country Infrastructure

In order to present an attractive setting for a manufacturing operation, it is important that the country's infrastructure be sufficiently developed to support a manufacturing operation. The required infrastructure will vary from company to company, but minimally, it will include power, transportation and roads, communications, service and component suppliers, a labor pool, civil order, and effective governance. In addition, a country must offer reliable access to foreign exchange for the purchase of necessary material and components from abroad as well as a physically secure setting where work can be done and product can be shipped to customers.

A country may have cheap labor, but does it have the necessary supporting services or infrastructure to support a manufacturing activity? Many countries offer these conditions, including Hong Kong, Taiwan, and Singapore. There are many other countries that do not, such as Lebanon, Uganda, and El Salvador. One of the challenges of doing business in the new Russian market is an infrastructure that is woefully inadequate to handle the increased volume of shipments. The Mexican government, anticipating much heavier trade volume because of NAFTA, has committed billions of dollars for infrastructure improvements.

Political Factors

As discussed in Chapter 5, political risk is a deterrent to investment in local sourcing. Conversely, the lower the level of political risk, the less likely it is that an investor will avoid a country or market. The difficulty of assessing political risk is inversely proportional to a country's stage of economic development: All other things being equal, the less developed a country, the more difficult it is to predict political risk. The political risk of the Triad countries, for example, is quite limited as compared to that of a less-developed country in Africa, Latin America, or Asia. The recent rapid changes in Central and Eastern Europe and the dissolution of the Soviet Union have clearly demonstrated the risks *and* opportunities resulting from political upheavals.

[12] Barbara Hagenbaugh, "Moving Work Abroad Tough for Some Firms," *USA Today*, December 3, 2003, p. 2B.

Other political factors may weigh on the sourcing decision. For example, with protectionist sentiment on the rise, for example, the U.S. Senate recently passed an amendment that would prohibit the U.S. Treasury and Department of Transportation from accepting bids from private companies that use offshore workers. In a highly publicized move, the state of New Jersey changed a call center contract that had shifted jobs offshore. About one dozen jobs were brought back instate—at a cost of about $900,000.

Market access is another type of political factor. If a country or a region limits market access because of local content laws, balance-of-payments problems, or any other reason, it may be necessary to establish a production facility within the country itself. The Japanese automobile companies invested in U.S. plant capacity because of concerns about market access. By producing cars in the United States, they have a source of supply that is not exposed to the threat of tariff or import quotas. Market access figured heavily in Boeing's decision to produce airplane components in China. China ordered 100 airplanes valued at $4.5 billion; in return, Boeing is making investments and transferring engineering and manufacturing expertise.[13]

Foreign Exchange Rates

In deciding where to source a product or locate a manufacturing activity, a manager must take into account foreign exchange rate trends in various parts of the world. Exchange rates are so volatile today that many companies pursue global sourcing strategies as a way of limiting exchange-related risk. At any point in time, what has been an attractive location for production may become much less attractive due to exchange rate fluctuation. For example, *endaka* is the Japanese term for a strong yen. In 2003, the exchange rate went from ¥122/$1 to ¥107/$1. For every one yen increase relative to the American dollar, Canon's

global MARKETING Q&A

USA Today: "[In 2003] you cut 2,000 U.S. jobs by closing a Wrangler factory. How should companies respond to criticism about moving jobs offshore?"

Mackey McDonald, Chief Executive Officer, VF Corp.: "The most important thing is to stay competitive. If you don't, all jobs will be lost. We stay competitive and increase some of the higher-paying jobs. The American consumer will buy the best product at the best price. That's the deciding factor, and you can't lose sight of it."

USA Today: "Are critics of offshoring naïve?"

Mackey McDonald: "What they say resonates with everyone. We want more jobs in this country. Without them, they can't buy apparel. We're all concerned. But those who are shouting aren't offering solutions, they're just shouting. This country has gone through transition for centuries. That's why we have the standard of living that we do. The solution is education and training, to keep our workforce moving into higher-paying jobs."

Source: Ron Insana, "Executive Suite: Do You Wear VF Clothes? Probably," USA Today, *November 15, 2004, p. 3B.*

[13] Jeff Cole, Marcus W. Brauchli, and Craig S. Smith, "Orient Express: Boeing Flies into Flap over Technology Shift in Dealings with China," *The Wall Street Journal,* October 13, 1995, pp. A1, A11. See also Joseph Kahn, "Clipped Wings: McDonnell Douglas' High Hopes for China Never Really Soared," *The Wall Street Journal,* May 22, 1996, pp. A1, A10.

operating income declines ¥6 billion! As noted earlier, Canon's management is counting on R&D investment to ensure that its products deliver superior margins that offset the strong yen.

The dramatic shifts in price levels of commodities and currencies are a major characteristic of the world economy today. Such volatility argues for a sourcing strategy that provides alternative country options for supplying markets. Thus, if the dollar, the yen, or the mark becomes seriously overvalued, a company with production capacity in other locations can achieve competitive advantage by shifting production among different sites.

summary

A company's first business dealings outside the home country often take the form of **exporting** or **importing**. Companies should recognize the difference between **export marketing** and **export selling**. By attending **trade shows** and participating in **trade missions,** company personnel can learn a great deal about new markets.

Governments use a variety of programs to support exports, including tax incentives, subsidies, and export assistance. Governments also discourage imports with a combination of **tariffs** and **nontariff barriers**. Export-related policy issues include the status of **foreign sales corporations** (**FSC**) in the United States, Europe's **Common Agricultural Policy** (**CAP**), and **subsidies.**

The **Harmonized Tariff System** (**HTS**) has been adopted by most countries that are actively involved in export-import trade. **Single-column tariffs** are the simplest; **two-column tariffs** include special rates such as those available to countries with **normal trade relations** (**NTR**) status. Governments can also impose special types of duties. These include **antidumping duties** imposed on products whose prices government officials deem too low and **countervailing duties** to offset government subsidies.

Key participants in the export-import process include **foreign purchasing agents**, **export brokers**, **export merchants**, **export management companies**, **manufacturers' export representatives, export distributors**, export commission representatives, cooperative exporters, and freight forwarders.

A number of export-import payment methods are available. A transaction begins with the issue of a **pro forma invoice** or some other formal document. A basic payment instrument is the **letter of credit (L/C)** that assures payment from the buyer's bank. Sales may also be made using a **bill of exchange** (**draft**), **cash in advance**, **sales on open account**, or a **consignment** agreement.

Exporting and importing is directly related to a management's decisions regarding **sourcing**. Concern is mounting in developed countries about job losses linked to **outsourcing** of jobs, both skilled, and unskilled, to low-wage countries. A number of factors determine whether a company makes or buys the products it markets as well as *where* it makes or buys.

discussion questions

1. What is the difference between export marketing and export selling?
2. Why is exporting from the United States dominated by large companies? What, if anything, could be done to increase exports from smaller companies?
3. Describe the stages a company typically goes through as it learns about exporting.
4. Governments often pursue policies that promote exports while limiting imports. What are some of those policies?
5. What are the various types of duties that export marketers should be aware of?
6. What is the difference between an L/C and other forms of export-import financing? Why do sellers often require L/Cs in international transactions?
7. What criteria should company management consider when making sourcing decisions?

web resources

The U.S. Department of Commerce provides export support through its Market Access and Compliance Web site. Visit MAC Online at:

www.mac.doc.gov

The U.S. federal government provides information on the HTS at:

www.usitc.gov/tata/index.htm

The database maintained by the U.S. International Trade Commission can be accessed at:

http://dataweb.usitc.gov

Case 8-1

Concerns About Factory Safety and Worker Exploitation in Developing Countries

In April 1997, President Bill Clinton announced the creation of a code of conduct aimed at combating sweatshops on a worldwide basis. Representatives from Phillips-Van Heusen (PVH), Nike, Reebok, Liz Claiborne, and six other manufacturers had served on a task force that spent eight months studying the sweatshop issue. The code established a minimum age of 14 for apparel workers and a maximum work week of 60 hours. Companies were required to pay the prevailing minimum wage in the country where the factory was located. Michael Posner, executive director of the Lawyers Committee for Human Rights, hailed the code as a breakthrough agreement. "It establishes a framework that provides consumers with confidence that companies are making good-faith efforts to address sweatshop practices," he said. Despite such optimism, the manufacturers and human rights advocates that were task force members disagreed on several issues. One concern was countries in which the official minimum wage was not a true "living wage" sufficient to support a family. Another issue was monitoring labor practices; the manufacturers wanted the right to select accounting firms, while activists and labor groups wanted nonprofit groups to perform the task of monitoring.

Background to the Code of Conduct

In August 1995, federal agents raided a garment-manufacturing facility near Los Angeles. The agents discovered 60 people, all from Thailand, who worked as many as 22 hours per day for $1.60 an hour to repay expenses for travel to the United States. The U.S. Labor Department charged the six Thai nationals believed to be running the sweatshop operation with harboring illegal immigrants and smuggling immigrants. The labor department also alleged that May Department Stores, Sears, and other retailers were selling goods that originated in the Los Angeles factory. Under the Fair Labor Standards Act, the labor department was authorized to hold the various apparel manufacturers that bought goods from the sweatshop legally liable for $5 million in worker back pay.

A year later, the sweatshop issue stayed in the news thanks to Kathie Lee Gifford, who was best known to television viewers as the host of a popular talk show and as a celebrity endorser who appeared in ads for Carnival Cruise Lines and Ultra Slim-Fast. Many Wal-Mart shoppers also associated Kathie Lee's name with a line of moderately priced apparel. Some items in the Kathie Lee clothing line were produced under contract in factories in Honduras and other developing countries. Labor rights activist Charles Kernaghan charged that working conditions in many of those factories fit the definition of "sweatshop": long hours, low wages, and abusive supervisors. Moreover, many employees in the factories were alleged to be minors. Kernaghan accused Gifford and other endorsers of profiting from worker exploitation.

Sweatshops in the Spotlight

The sweatshop bust in Los Angeles and the revelations surrounding Kathie Lee Gifford finally focused the public's attention on an issue that had been gathering momentum for years. Catastrophic industrial fires in several countries have resulted in

extensive loss of life. In Dongguan, China, 80 workers died in a fire at a raincoat factory in 1991. In 1993, 84 people were killed in a handicrafts factory fire in the Chinese city of Shenzhen. The most deadly industrial fire in history broke out on May 10, 1993, in a four-story toy factory near Bangkok, Thailand. Nearly 200 workers—most of whom were women and teenage girls—died in the blaze. The factory was owned by Kader Industrial Toy Company, which supplies toys to well-known U.S. companies such as Fisher-Price, Toys "R" Us, and Hasbro. One reason so many perished is that several emergency exit doors were locked.

Government support is just one reason that companies can rely on far-flung manufacturing; 900 million, about 15 percent, of the world's 6 billion people are unemployed. Thus, governments in many countries encourage foreign investment that will create jobs. Moreover, manufacturing companies account for nearly three-fourths of the dollar value of world trade. Improved communications technology allows company headquarters to closely monitor operations throughout the world. As John Cavanagh, a fellow at Washington's Institute for Policy Studies, explains, "Companies can coordinate production in plants scattered all over the world on a real-time, minute-to-minute basis."

Not surprisingly, many U.S. companies are scouring the globe for low-cost sources of labor. As wages have increased in South Korea, Taiwan, and Singapore, offshore assembly and manufacturing has moved to developing countries such as Indonesia, Thailand, India, Mexico, and China. For example, almost half of all the toys sold in the United States are produced in Asia; in 1992, Chinese factories turned out $3.3 billion worth of toys for the United States. The minimum wage in China is about $0.80 per day.

Disturbed by the trend, many U.S. observers had long characterized factories in developing countries as sweatshops where "semislave labor" was forced to work in inhumane, unsafe working conditions for extremely low wages. These critics suggest that profit-hungry American executives often turn a blind eye to working conditions outside the United States. For their part, executives and industry spokespersons point out that, in many cases, U.S. companies do not own the factories where goods are made. Labor movement representatives in the United States, concerned that U.S. companies are unwilling to support improved working conditions abroad, have even attempted to align with labor movements in developing countries.

Despite the terrible tragedies in Thailand and China, not everyone in the United States agrees with the view that workers in developing countries are being exploited. Although wages in some countries may seem low by U.S. standards, they are relatively high by Asian standards. Compared to an agriculture-based subsistence standard of living, these wages represent both an improvement and an important step forward in terms of economic development. As advocates of global production point out, wages in Japan, Taiwan, and South Korea were low in the years after World War II, but increased as those countries' economies developed. The first step toward a developed economy involved sweatshops. As economist Paul Krugman noted, "The overwhelming mainstream view among economists is that the growth of this kind of employment is tremendous good news for the world's poor." Krugman has adopted a pragmatic viewpoint on the child labor issue. Noting that some impoverished parents sell their children to syndicates who force them to work as beggars, Krugman says, "If that is the alternative, it is not so easy to say that children should not be working in factories.

Still, some experts predict that business executives are starting to realize that it is simply good business to be concerned with factory conditions. Notes Professor Elliot Schrage of Columbia University, "Many companies are being forced to examine their labor practices around the world by consumer pressure or fear of consumer backlash." The U.S. government hoped that publicizing the names of retailers who bought from the Los Angeles manufacturers would encourage retailers to improve their social responsibility policies.

Nike and the Sneaker Controversy

The truth in Schrage's observation has been amply illustrated in the athletic shoe industry. Nike, Reebok, and other sneaker marketers source virtually 100 percent of their shoes in Asia, where contractors are responsible for the production of the shoes. For example, 80 million pairs of Nikes are manufactured each year in dozens of factories outside the United States. During the 1980s, most of Nike's manufacturing was located in South Korea and Taiwan. As workers there gained the right to organize and strike, wage rates increased. Nike responded by shifting production to China, Malaysia, Indonesia, and Thailand and leaving 20 closed factories in its wake. In Indonesia, where 50 factories make shoes for Nike, the nonunion workforce is made up mostly of young women paid wages starting at about $1.35 a day. Nike subcontractors employ an estimated 300,000 young Asian women.

Nike's practice of following cheap labor around the globe made it the target of criticism from the ranks of workers and scholars alike. For example, *Solidarity* magazine, published by the United Auto Workers, once urged union members to send their "dirty, smelly, worn-out" running shoes to Nike as a way of protesting overseas production. John Cavanagh and others have written numerous articles criticizing Nike for profiting at the expense of low-wage workers. Cavanagh has pointed out that, although 2.5 million people enter the Indonesian job market each year, employment options are so limited that most people can only find work making athletic shoes. Low wages permit only subsistence living in shanties without electricity or plumbing and also result in malnutrition. Nike pays superstar Michael Jordan $20 million annually in endorsement fees, an amount that has been estimated to exceed the total annual wages for Indonesian workers who make the sneakers.

For several years, Nike executives responded to inquiries about working conditions in contract factories by noting that the company focuses on marketing and design rather than manufacturing. Still, the company was coming under increased pressure from both human rights groups and the general public to address the sweatshop issue. In 1997, Nike commissioned former U.N. ambassador Andrew Young to visit some of the Asian factories and report his findings. After spending 15 days personally inspecting working conditions, Young reported that he did not find abuse or mistreatment of workers. Critics took Nike to task for asking Young to focus only on working conditions and failing to investigate wage rates as well. However, in September 1997, Nike canceled contracts with four factories in Indonesia where pay was below minimum government levels. By 1998, the controversy began to affect Nike's bottom line. Nike's profits dropped as sneaker sales slumped. The sweatshop backlash was not the only cause, however; increasing numbers of consumers were turning to "brown shoes," snapping up casual wear from Hush Puppies, Timberland, and other makers.

Nike was not the only company caught up in the controversy. Allegations surfaced that a subcontractor for Adidas-Salomon AG employed Chinese political prisoners in labor camps near Shanghai to sew soccer balls that commemorated the 1998 World Cup. Adidas, like Nike, has adopted a code of conduct and closely monitors production to prevent such things from occurring. The allegations came as President Clinton was visiting China with an agenda that downplayed human rights issues. An estimated 230,000 Chinese are held in camps dedicated to "reeducation through labor." Soccer balls are hand sewn from 32 precut panels, a process that is so labor-intensive that the work is often done in rural "stitching centers" with the country's lowest labor costs. Adidas confirmed that the allegations were based in fact but that the prison labor had been utilized without the company's knowledge. Adidas announced that it would not source soccer balls in China until production was centralized in one location that excluded the possibility of using prison labor.

Visit the Web site

Read Nike's Revised Code of Conduct and learn more about the company's labor practices at:

www.nikebiz.com

Global Exchange, a human rights group, offers information on efforts to combat sweatshops:

www.globalexchange.org

Discussion Questions

1. Do you think toy company executives—in Japan, the United States, and elsewhere—should take steps to ensure the safety and welfare of factory workers in developing countries? Why or why not?
2. How have the low wages paid in developing country manufacturing operations affected the number of manufacturing jobs in the high-wage Triad countries?
3. If higher wages in toy factories led to higher prices in the United States for toys, how would it affect the toy industry?
4. Should international trade agreements include guidelines and requirements for working conditions?
5. Do you think companies are doing enough to act responsibly and ensure that human rights standards are upheld for workers both inside and outside their home countries?

Sources: Craig S. Smith and A. Craig Copetas, "For Adidas, China Could Prove Trouble," *The Wall Street Journal,* June 26, 1998, p. A13; Holman W. Jenkins, Jr. "The Rise and Stumble of Nike," *The Wall Street Journal,* June 3, 1998, p. A19; Steven Greenhouse, "Accord to Battle Sweatshop Labor Faces Obstacles," *The New York Times,* April 13, 1997, pp. 1, 13; Allen R. Myerson, "In Principle, a Case for More 'Sweatshops,'" *The New York Times,* June 22, 1997, p. 5; Asra Q. Nomani, "Labor Department Asks $5 Million for Alleged Worker Enslavement," *The Wall Street Journal,* August 16, 1995, p. B4; Lori Ioannou, "Capitalizing on Global Surplus Labor," *International Business* (April 1995), pp. 32–34+; G. Pascal Zachary, "Multinationals Can Aid Some Foreign Workers," *The Wall Street Journal,* April 24, 1995, p. A1; Bob Herbert, "Terror in Toyland," *The New York Times,* December 21, 1994, p. A27; "102 Dead in Thai Factory Fire; Higher Toll Seen," *The New York Times,* May 11, 1993, p. A3; "Thai Factory Fire's 200 Victims Were Locked Inside, Guards Say," *The New York Times,* May 12, 1993, p. A5; Jeffrey Ballinger, "The New Free-Trade Heel," *Harper's Magazine,* August 1992 pp. 46–47; Geraldine E. Willigan, "High-Performance Marketing: An Interview with Nike's Phil Knight," *Harvard Business Review* (July–August 1992) pp. 91–101; Richard J. Barnet and John Cavanagh, "Just Undo It: Nike's Exploited Workers," *The New York Times,* February 13, 1994, Section 3, p. 11.

Case 8-2

U.S. Sugar Subsidies: Too Sweet a Deal?

A turf war has broken out over one of the humblest commodities traded on world markets: sugar. On one side are small-scale farmers in some of the poorest regions of the world; desperate to increase their incomes and improve their living standards, these farmers seek increased exports of sugar cane. On the other side are farmers in some of the richest nations in the world who are equally intent on preserving a system of quotas and subsidies to support production of sugar cane and sugar beets. Caught in the middle are processed food and beverage companies that use sugar in baked goods, ice cream, jams and jellies, soft drinks, and a range of other products. There is also an impact on consumers: Sugar subsidies result in higher prices for popular food and beverage products.

The debate over agricultural policy is at the heart of the struggle. Worldwide, agricultural subsidies amount to approximately $300 billion each year. The subsidies issue has been central to the current round of global trade negotiations; it has also been debated at the World Summit on Sustainable Development. Brazil, Australia, and Thailand rank first, third, and fourth, respectively, among top sugar exporters; the EU ranks second. Collectively, Brazil, Australia, and Thailand have challenged the EU's sugar export policy at the WTO.

In Europe, protection of the agricultural sector was a response to the shortages and rationing that occurred during World War II. Thanks to an initiative known as the Common Agricultural Policy (CAP), European farmers supply virtually all Europe's food consumption needs. Ag producers also made gains in the 1960s in negotiations relating to the creation of the Common Market—the precursor to today's EU. The EU currently spends more than $90 billion each year to support domestic agriculture; ironically, the EU also spends $25 billion in development aid for low-income nations. Former French president Jacques Chirac was a particularly vocal advocate of EU farm policy, and farmers in France are well organized. The current EU farm bill expired in 2006.

Europe's agricultural policies have led to sugar beet production in Sweden and Finland—countries not renowned for favorable growing conditions—as well as France. The impact of the sugar regime is clear: European farmers operate with quotas that specify how much they can produce. The farmers are also guaranteed prices for their crops that are roughly three times higher than the world price. Furthermore, the EU produces much more sugar than it can use; as a result, about 6 tons of European sugar are dumped on the world market each year. Moreover, EU sugar supports benefit former colonies such as Mauritius and Fiji, which sell raw sugar to the EU at the higher, protected prices. However, these imports are offset by an equivalent amount of exports from the EU; the annual cost of this practice to EU taxpayers is estimated at $800 million.

In the United States, the current sugar regime can be traced back to the Sugar Act of 1934. The act was designed to stabilize prices; today, as in Europe, the U.S. price for raw sugar is about three times the world market price. The General Accounting Office estimates that the program costs Americans $2 billion annually in inflated sugar prices; it will cost an additional $2 billion to store surplus sugar over the course of 10 years. In contrast to Europe, however, the United States exports only a fraction of the 8 tons of sugar it produces each year; quotas limit sugar imports to about 15 percent of U.S. consumption. The U.S. government pays approximately $50 billion in farm aid each year; in May 2002, president George W. Bush signed a new farm bill that actually increased support to some farmers. Not surprisingly, the Europeans point to the bill as evidence that the United States is hypocritical on trade issues. U.S. sugarcane and sugar beet producers rank first in contributions to political campaigns, ahead of both tobacco farmers and dairy farmers. Florida, the key sugar producing state, is a crucial swing state in national elections. However, sugar beets are also grown in North Dakota and other states in the northern plains.

The Sugar Association heads the industry's lobbying effort in the United States. However, the industry flexes its political muscle in other ways. For example, the WHO and the Food and Agriculture Organization have identified sugar as a key contributor to obesity. A recent report titled *Diet, Nutrition and the Prevention of Chronic Diseases* recommended that no more than 10 percent of an individual's caloric intake should come from "added sugars." The Sugar Association assailed the "'dubious nature" of the report, and implied that more than $400 million in congressional funding to the World Health Organization (WHO) could be jeopardized. Andrew Briscoe, president of the association, said, "We are not opposed to a global strategy in the fight against obesity. No one, including the sugar industry, wants anybody to be obese and we want to be part of the solution. But we want that solution to be based on the preponderance of science."

President Bush's administration has actively pursued bilateral and regional trade agreements, a fact that also has the sugar industry up in arms. For example, as part of the newly-negotiated Central American Free Trade Agreement, the United States agreed to import 100,000 tons of sugar—about 1 percent of the U.S. market—from Guatemala and its neighbors. Industry reaction was swift. Robert Coker, senior vice president of Florida-based U.S. Sugar Corporation, "If the U.S. agrees in regional trade negotiations to open up the U.S. sugar market, American sugar producers, including our company, will be wiped out." The president of the American Sugarbeet Growers Association summed up the situation more succinctly. "If you go to free trade, Brazil wins and everybody else gets killed," he said. As noted earlier, Australia is the world's number three sugar exporter; however, when the United States and Australia completed negotiations on a free trade agreement in 2004, sugar was not included.

Discussion Questions

1. Why do Europe and the United States spend so much on agricultural subsidies?
2. Do individual consumers care where their sugar comes from? If not, should they?
3. Which poses the biggest threat to sugar producers in wealthy countries, the growing concern over obesity or increased imports from developing countries?

Sources: Tobias Buck, "EU to Consider Sugar Subsidy Reform," *Financial Times,* June 24, 2004, p. 7; Robert B. Zoellick, "Don't Get Bitter About Sugar," *The Wall Street Journal,* February 25, 2004, p. A14; Edward Alden and Neil Buckley, "Sweet Deals: 'Big Sugar' Fights Threats from Free Trade and a Global Drive to Limit Consumption," *Financial Times,* February 27, 2004, p. 11; Mary Anastasia O'Grady, "Clinton's Sugar Daddy Games Now Threaten NAFTA's Future," *The Wall Street Journal,* December 20, 2002, p. A15; Roger Thurow and Geoff Winestock, "Bittersweet: How an Addiction to Sugar Subsidies Hurts Development," *The Wall Street Journal,* September 16, 2002, pp. A1, A10.