chapter 13

Exporting and Countertrade

Learning Objectives

In this chapter, you will learn about:

1. An overview of foreign market entry strategies
2. The internationalization of the firm
3. Exporting as a foreign market entry strategy
4. Managing export-import transactions
5. Methods of payment in exporting and importing
6. Cost and sources of export-import financing
7. Identifying and working with foreign intermediaries
8. Countertrade

Exporter's Dogged Pursuit of International Customers

Is your pet having a bad hair day? Or is your horse's mane looking dull? Sharon Doherty, president of Vellus Products, Inc., can help. Vellus is a small company in the United States that makes pet grooming products such as customized shampoos, conditioners, brushing sprays, and detanglers. According to Doherty, shampoos for people don't work well on pets because animals' skin is more sensitive than humans and is easily irritated.

Vellus' first export sale was to a Taiwanese importer who purchased $25,000 worth of products to sell at Taiwan dog shows. The word was out. "I started receiving calls from people around the world who heard of our products and asked how they could get in touch with me to buy them," Doherty recalls. "But I needed a way to do market research and learn more about ways of doing business in these countries." Vellus had to adapt some of its marketing for foreign markets to meet local conditions.

Vellus has become quite familiar with the cultural aspects of pet care. In England, dog exhibitors prefer less poofed-out topknots than those in show dogs in the United States, where owners prefer more exotic topknots. In England, dog exhibitors prefer Shih-Tzus with a big head, long back, and who are somewhat lower to the ground,

while U.S. exhibitors prefer Shih-Tzus with more leg and a shorter back. These preferences determine the types of shampoos and brushes that each country needs.

Exporting benefits firms such as Vellus by increasing sales and profits and diversifying their customer base. As an entry strategy, exporting is low cost, low risk, and uncomplicated. These are big advantages for smaller firms like Vellus that typically lack substantial financial and human resources. Exporting also helps stabilize fluctuations in sales volume. For instance, because dog shows take place abroad during different parts of the year, exporting helps stabilize Vellus' sales levels.

Firms like Vellus take advantage of support provided by intermediaries located abroad. Doherty often gives advice and guidance to her foreign-based distributors, sharing her knowledge and understanding of importing along with marketing in the dog show network. She says this advice is much appreciated and goes a long way to building long-term relationships. Doherty also makes sure to do her homework on potential distributors. "Gather as much information as you can. Don't make any assumptions—the wrong choice can cost your business valuable time and money."

Exporters like Vellus locate foreign distributors using various methods. One approach is to attend a trade fair in the target country. In Vellus' case, management discovered potential distributors by attending foreign dog shows. Other companies consult country and regional business directories, foreign yellow pages, industry trade associations, and government sources.

Vellus received guidance from government agencies that support small-firm exporting. "They provided me with lots of help and an abundance of excellent information," Doherty said. Having done her homework, it's no wonder Vellus Products continues to flourish. The firm has a wide range of clients, from the rich and famous to distributors, breeders, and individual pet owners around the world. The president of the United Arab Emirates is a regular customer; his stables buy Vellus products for his horses twice a year.

To date, Vellus has sold its products in 28 countries, including Australia, Canada, China, England, Finland, New Zealand, Norway, Singapore, South Africa, and Sweden. Roughly half the firm's revenues come from exports. All told, more than 300 breeds of pampered pooches are strutting their stuff with the help of Vellus Products. Management has registered the firm's trademark in 15 countries, and looks to expand export sales.

Sources: Judy, Jo Ann. (1998). "Worldwise Women," *Small Business News,* July 01, p. 21; Pavilkey, Susan. (2001). "Pet Product Maker Gives International Clients Royal Treatment," *Business First,* Jan 19, p. A20; U.S. Department of Commerce, at *www.export.gov/comm_svc/press_room/news/articles*

An Overview of Foreign Market Entry Strategies

As we begin Part Four of this book, let's review foreign market entry strategies that companies use to expand abroad. Recall Chapter 3, where we discussed the following three categories of internationalization strategies for the focal firm:

Global sourcing The strategy of buying products and services from foreign sources; also referred to as importing, global procurement, or global purchasing.

Exporting The strategy of producing products or services in one country (often the producer's home country), and selling and distributing them to customers located in other countries.

Countertrade An international business transaction where all or partial payments are made in kind rather than cash.

1. International transactions that involve the exchange of products are *home-based* international trade activities, such as *global sourcing, exporting,* and *countertrade.* **Global sourcing** (also known as importing, global procurement, or global purchasing) refers to the strategy of buying products and services from foreign sources. While sourcing or importing represents an inbound flow, exporting represents *outbound* international business. Thus, **exporting** refers to the strategy of producing products or services in one country (often the producer's home country), and selling and distributing them to customers located in other countries. In both global sourcing and exporting, the firm manages its international operations largely from the home country. We discuss global sourcing in greater detail in Chapter 16. **Countertrade** refers to an international business transaction where all or partial payments are made in kind rather than cash. That is, instead of receiving money as payment for exported products, the firm receives other products or commodities.

2. Contractual relationships are most commonly referred to as *licensing* and *franchising.* By using licensing and franchising, the firm allows a foreign partner to use its intellectual property in return for royalties or other compensation. Firms such as McDonalds, Dunkin' Donuts, and Century 21 Real Estate use franchising to serve customers abroad. We discuss contractual strategies for foreign market entry in Chapter 15.

3. Equity or ownership-based international business activities typically involve *foreign direct investment (FDI)* and equity-based *collaborative ventures.* In contrast to home-based international operations, the firm establishes a presence in the foreign market by investing capital and securing ownership of a factory, subsidiary, or other facility there. Collaborative ventures include joint ventures in which the firm makes similar equity investments abroad, but in partnership with another company. We discuss FDI and collaborative ventures in Chapter 14.

Each foreign market entry strategy has its advantages and disadvantages, and each places specific demands on the firm's managerial and financial resources.

Broadly, exporting, licensing, and franchising require a relatively low level of managerial commitment and dedicated resources. By contrast, FDI and equity-based collaborative ventures necessitate a high level of commitment and resources.

Managers typically consider the following six variables when selecting an entry strategy:

1. The *goals* and *objectives* of the firm, such as desired profitability, market share, or competitive positioning.
2. The particular financial, organizational, and technological *resources* and *capabilities* available to the firm.
3. *Unique conditions in the target country,* such as legal, cultural, and economic circumstances, as well as the nature of business infrastructure, such as distribution and transportation systems.
4. *Risks* inherent in each proposed foreign venture in relation to the firm's goals and objectives in pursuing internationalization.
5. The nature and extent of *competition* from existing rivals and from firms that may enter the market later.
6. The *characteristics of the product or service* to be offered to customers in the market.

The specific characteristics of the product or service, such as its composition, fragility, perishability, and the ratio of its value to its weight, can strongly influence the type of internationalization strategy that management chooses for expanding abroad. For example, products with a low value/weight ratio (such as tires, cement, and beverages) are expensive to ship long distances, suggesting that the firm should internationalize through a strategy other than exporting. Similarly, fragile or perishable goods (such as glass and fresh fruit) are expensive or impractical to ship long distances because they typically require special handling or refrigeration. Complex products (such as medical scanning equipment and computers) require substantial technical support and after-sales service, which might necessitate a substantial presence in the foreign market.

The Internationalization of the Firm

In this chapter, we explore home-based international trade activities: exporting, importing, and countertrade. Exporting is the typical foreign market entry strategy for most firms, and thus it deserves greater attention. Before discussing exporting in detail, let's consider the nature and characteristics of firm internationalization.

Diverse Motives for Pursuing Internationalization

When selecting an entry mode, managers must identify the firm's underlying motivation for venturing abroad. Companies internationalize for a variety of reasons.[1] Some motivations are *reactive* and others *proactive.* For example, following major customers abroad is a reactive move. When large automakers such as Ford or Toyota expand abroad, their suppliers are compelled to follow them to foreign markets. Automotive suppliers, such as Robert Bosch, Denso, Lear, TRW, and Valeo quickly set up their own international operations. By contrast, seeking high-growth markets abroad or preempting a competitor in its home market are proactive moves. Companies such as Vellus, discussed in the opening vignette, are pulled into international markets because of the unique appeal of their products. Multinational enterprises (MNEs), such as Hewlett-Packard, Kodak, Nestlé, AIG, and Union Bank of Switzerland may venture abroad to

SMEs such as Vellus Products, Inc., maker of pet-grooming products, internationalize quickly because of their unique product appeal. Here, a Great Dane is showcased at Crufts in Birmingham, England, the world's largest dog show.

enhance various competitive advantages, learn from foreign rivals, or pick up ideas about new products.

For companies that launch exporting, licensing, or franchising ventures, internationalization motives tend to be relatively straightforward. In most cases, management seeks to maximize returns from investments that the firm has made in products, services, and know-how by seeking a broader customer base located abroad. When companies such as Boston Scientific (medical instruments), Subway, and Starbucks internationalize, they are essentially exploiting their competitive assets in a broader geographic space. In contrast, FDI and collaborative ventures usually involve more complex motivations. They pose greater risks for managers and require careful consideration of the likely costs and benefits of internationalization. For example, the Swedish appliance maker Electrolux recently built assembly operations in such diverse markets as Hungary, Mexico, Poland, Russia, and Thailand. Home appliances represent a complex global industry in which profit margins are tight and competition is intense. By undertaking product development, manufacturing, supply-chain coordination, and workforce management in relatively risky markets, Electrolux has taken on formidable challenges.[2]

Characteristics of Firm Internationalization

What are typical patterns and characteristics associated with the process of international expansion?[3] Five conclusions can be reached.

1. *Push and pull factors serve as initial triggers.* Typically a combination of triggers, internal to the firm and in its external environment, is responsible for initial international expansion. *Push factors* include unfavorable trends in the domestic market that compel firms to explore opportunities beyond national borders. Examples include declining demand, falling profit margins, growing competition at home, and reliance on products that have reached a mature phase in their life cycle. *Pull factors* are favorable conditions in foreign markets that make international expansion attractive. Examples include situations in which management desires faster growth and higher profit margins, or the will to enter markets that have fewer competitors, foreign government incentives, or opportunities to learn from competitors. Often, both push and pull factors combine to motivate the firm to internationalize.

2. *Initial involvement may be accidental.* For many firms, initial international expansion is unplanned. Many companies internationalize "by accident" or because of fortuitous events. For example, DLP, Inc., a manufacturer of medical devices for open-heart surgery, made its first major sale to foreign customers that the firm's managers met at a trade fair. Without necessarily meaning to, the firm got started in international business right from its founding. Vellus Products, the firm discussed in the opening vignette, started exporting because a foreign distributor decided to showcase the firm's products at a dog show in Taiwan. Such reactive or unplanned internationalization has been typical of many firms prior to the 1980s. Today, because of growing pressures from international competitors and the increasing ease with which internationalization can be achieved, firms tend to be more deliberate in their international ventures.

3. *Balancing risk and return.* Managers weigh the potential profits, revenues, and achievement of strategic goals of internationalization against the initial investment that must be made in terms of money, time, and other company resources. The greater the anticipated returns, the more likely it is that management will pursue an international project and commit resources necessary to ensure its success. Because of increased costs and greater complexity, international ventures often take longer to become profitable than domestic ventures. Risk-taking preferences of managers determine what initial investments the firm will make and its tolerance for delayed returns. Risk-averse managers tend to prefer more conservative international projects that involve relatively safe markets and entry strategies. These managers tend to target foreign markets that are culturally close; that is, they have a similar culture and language to the home country. For example, a risk-averse U.S. company would favor Canada over China. A risk-averse Australian company would prefer Britain over Nigeria.

4. *An ongoing learning experience.* Internationalization is a gradual process that can stretch over many years and involve entry into numerous national settings. There are ample opportunities for managers to learn and adapt how they do business. If profits are attractive, management will commit increasing resources to international expansion and will seek additional foreign opportunities that, in turn, result in more learning opportunities. Eventually, internationalization develops a momentum of its own, as direct experience in each new market reinforces learning and positive results pave the way for greater international expansion.[4] Active involvement in international business provides the firm with many new ideas and valuable lessons that it can apply to the home market and to other foreign markets. For example, in the process of developing fuel-efficient automobiles for the United States, General Motors (GM) turned to its European operations, where it had been marketing smaller cars for some time. GM leveraged ideas that it had acquired in Europe to develop fuel-saving cars for the U.S. market.

5. *Firms may evolve through stages of internationalization.* Historically, most firms have opted for a gradual, incremental approach to international expansion. Even today most firms internationalize in stages, employing relatively simple and low-risk internationalization strategies early on and progressing to more complex strategies as the firm gains experience and knowledge. Exhibit 13.1 illustrates the typical firm's internationalization stages and the justifications for each stage. In the *domestic market focus* stage, management focuses on only the home market. In the *experimental stage,* management tends to target low-risk, culturally close markets, using relatively simple entry strategies such as exporting or licensing. As management gains experience and competence, it enters the *active involvement* and *committed involvement* stages. Managers begin to target increasingly complex markets, using more challenging entry strategies such as FDI and collaborative ventures.

While firms generally follow the pattern described in Exhibit 13.1 when expanding abroad, today born global firms internationalize much faster than companies did in the past. Born globals reach a stage of active involvement in international business within the first few years of their founding.

Exporting as a Foreign Market Entry Strategy

Because it entails limited risk, expense, and knowledge of foreign markets and transactions, most firms prefer exporting as their primary foreign market entry strategy. Typically, the focal firm retains its manufacturing activities in its home market but conducts marketing, distribution, and customer service activities in the export market. The focal firm can conduct the latter activities itself, or contract with an independent distributor or agent to have them performed.

Stages of internationalization	*Critical management activity or orientation*	*How the firm behaves*
Domestic market focus	Focus on home market	Firm operates only in its home market due to limited resources or lack of motivation
Preinternationalization stage	Research and evaluate the feasibility of undertaking international business activity	*Typical triggers from outside the firm:* • The firm receives unsolicited orders from customers located abroad. • Change agents (such as foreign distributors) contact the firm, seeking to represent it in their countries. *Typical triggers from inside the firm:* • Managers seek to increase the firm's performance or improve its competitive advantages. • Managers are proactive about international expansion.
Experimental involvement	Initiate limited international business activity, typically through exporting	• Managers consider foreign market opportunities attractive.
Active involvement	Explore international expansion, including entry strategies other than exporting	• Managers have accumulated experience that reinforces expectations about the benefits of international business. • Managers are willing to commit additional resources for international expansion. • Managers dedicate firm resources appropriate for expanding into new foreign markets.
Committed involvement	Allocate resources based on international opportunities	• The firm performs well in various international ventures. • The firm overcomes barriers to doing international business.

Exhibit 13.1 Typical Stages in Firm Internationalization

SOURCE: Adapted from S. Tamer Cavusgil (1980) "On the Internationalization Process of Firms," *European Research* 8 (6): 273–81.

Exporting is the entry strategy responsible for the massive inflows and outflows that constitute global trade. Exporting typically generates substantial foreign-exchange earnings for nations. Japan has benefited from massive inflows of export earnings for years. China has become the leading exporter in various sectors, providing enormous revenues to the Chinese economy. Smaller economies such as Belgium and Finland also add much to their foreign-exchange reserves from exporting, and use them to pay for their sizeable imports of foreign goods.

When government agencies cite statistics on trade deficits, trade surpluses, and the volume of merchandise trade for individual countries, these data generally refer to firms' collective exporting and importing activities. For example, the United States is the primary export market for Canadian goods, and accounts for some three-quarters of Canadian exports each year. The two-way trade between Canada and the United States represents the largest bilateral trade relationship in the world.

Exporting is a foreign entry strategy of manufacturers such as Boeing.

China recently surpassed Europe, Japan, and the United States to become the world's top exporter of information technology (IT) products. The speed of China's ascent has been startling. In 1996, China's exports of computers, mobile phones, and other IT goods amounted to only $36 billion. By 2006, the figure exceeded $300 billion. In the intervening years, almost all major Western IT firms had located much of their production in China, primarily because of its low-cost manufacturing and capable factory workers. China's success has occurred particularly at the expense of the United States, from which direct IT exports have declined substantially in recent years.[5]

Exporting: A Popular Entry Strategy

Firms venturing abroad for the first time usually use exporting as their entry strategy. Exporting is also the entry strategy most favored by small and medium-sized enterprises (SMEs), such as Vellus Products. Beyond initial entry, however, all types of firms, large and small, use exporting regardless of their stage of internationalization. For example, some of the largest exporters in the United States include big aircraft manufacturers such as Boeing and Lockheed. Big trading companies that deal in commodities, such as Cargill and Marubeni, are also large-scale exporters. Large manufacturing firms—those with more than 500 employees—typically account for the largest overall value of exports. Such firms account for about three-quarters of the total value of exports from the United States. However, the vast majority of exporting firms—more than 90 percent in most countries—are SMEs with fewer than 500 employees.

As an entry strategy, exporting is very flexible. Compared to more complex strategies such as foreign direct investment (FDI), the exporter can both enter and withdraw from markets fairly easily, with minimal risk and expense. Exporting may be employed repeatedly during the firm's internationalization process, generally at the early stages and again from production facilities that the firm eventually establishes at various foreign locations, destined for markets in other countries. Very experienced international firms usually export in combination with other strategies, such as joint ventures and foreign direct investment. For example, Toyota has used FDI to build factories in key locations in Asia, Europe, and North America. Toyota uses these production bases to export cars to neighboring countries and regions.

Exhibit 13.2 shows the degree to which various manufacturing industries, and firms within those industries, are dependent on international sales. The analysis is limited to large, publicly traded manufacturing companies in the United States. The data represent international sales from both the headquarter's country and the firm's foreign subsidiaries. The Exhibit suggests that firms in industries such as computers, chemicals, and medical equipment are more dependent on international sales than firms in industries such as electrical equipment, publishing, and autos. What are the common features of the most geographically diversified industries? Many are high value-added, high-technology industries subject to globalization. We also find, in general, the greater the tendency of

Industry	*Average international sales in the industry (as percentage of total sales)*	*Example of a leading firm in the industry*	*Example firm's international sales (as percentage of total sales)*
Computers & other electronic products	60%	Fairchild Semiconductor International Inc.	85%
Chemicals	44	OM Group Inc.	80
Medical instruments & equipment	42	Bio-Rad Laboratories Inc.	66
Motor vehicle parts	42	Autoliv Inc.	71
Communications equipment	40	Agere Systems Inc.	80
Pharmaceuticals	37	Schering-Plough Corp.	57
Aerospace & defense	36	Sequa Corp.	50
Food	32	Chiquita Brands International Inc.	73
Plastics	32	Tupperware Corp.	73
Apparel	31	Nike Inc.	56
Beverages	30	Coca-Cola Co.	73
Electrical equipment & appliances	28	Exide Technologies	59
Publishing & printing (including software)	27	Oracle Corp.	52
Motor vehicles	26	Paccar Inc.	55

Exhibit 13.2 International Sales Intensity of Various United States-Based Industries

SOURCE: Industry Week, www.industryweek.com/ReadArticle.aspx?Article ID=1480&Section ID=41.

the industry or the firm to retain manufacturing at home, the greater the dependence on international sales. For example, aircraft manufacturers tend to concentrate their manufacturing in Europe and the United States, yet market their products all over the world.

Service Industry Exports

In most advanced economies, services are the largest component of economic activity. Firms in virtually all services-producing industries market their offerings in foreign countries. These include industries such as travel, transportation, architecture, construction, engineering, education, banking, finance, insurance, entertainment, information, and professional business services. For example, Hollywood film studios earn billions by exporting their movies and videos. Construction firms send their employees abroad to work on major construction projects. Service professionals, such as accountants, engineers, and business consultants often provide their services via the Internet, by telephone and mail, and by visiting customers directly in their home countries. The U.S. firm PMI Mortgage Insurance Co. recently began exporting mortgage insurance packages to various foreign markets. Insurance packages can be created in a central location, such as London, and then exported via mail and the Internet to customers located in other countries. The firm enjoys considerable success in Asia and various European countries.[6]

However, services are distinct from products in certain key ways. Many *pure* services cannot be exported because they cannot be transported. For example, you cannot box up a haircut and ship it overseas. Most retailing firms, such as Carrefour and Marks & Spencer, offer their services by establishing retail stores in their target markets—that is, they internationalize via FDI because retailing requires direct contact with customers. In other cases, many services firms can export *some* of what they produce but rely on other entry strategies to provide *other* offerings abroad. For example, some aspects of professional services cannot be exported and require the firm to establish a physical presence in target markets. While Ernst & Young can export *some* accounting services by sending its employees abroad, in other cases it will establish a physical presence abroad by setting up an office. Ernst & Young then hires *local* personnel to perform local accounting services.

Overall, most services are *delivered* to foreign customers either through local representatives or agents, or marketed in conjunction with other entry strategies such as FDI, franchising, or licensing. The Internet provides the means to export some types of services, ranging from airline tickets to architectural services. The Internet is helping to make the service sector one of the fastest growing areas of exports in international business.[7]

Services can promote and maintain product exports. Many merchandise exports would not take place if they were not supported by service activities. For example, few people would want to buy a car if there were no repair services available to maintain it. Accordingly, firms that export cars must also provide a means for the vehicles to be repaired in the recipient countries. They establish customer service facilities in target markets through FDI, or they contract with local shops to provide such services.

Advantages of Exporting

Serving foreign customers through exporting has been a popular internationalization strategy throughout history because it offers firms a way to accomplish the following:

- Increase overall sales volume, improve market share, and generate profit margins that are often more favorable than in the domestic market.
- Increase economies of scale and therefore reduce per-unit cost of manufacturing.
- Diversify customer base, reducing dependence on home markets.
- Stabilize fluctuations in sales associated with economic cycles or seasonality of demand. For example, a firm can offset declining demand at home due to an economic recession by refocusing efforts toward those countries that are experiencing more robust economic growth.
- Minimize risk and maximize flexibility, compared to other entry strategies. If circumstances necessitate, the firm can quickly withdraw from an export market.
- Lower cost of foreign market entry since the firm does not have to invest in the target market or maintain a physical presence there. Thus, the firm can use exporting to test new markets before committing greater resources through foreign direct investment.
- Leverage the capabilities and skills of foreign distributors and other business partners located abroad.

The low-cost, low-risk nature of exporting, combined with the ability to leverage foreign partners, makes exporting especially suitable for SMEs. For example, small California wineries have begun to export their popular products around the world. Wine exports have reached nearly 20 percent of total output for these modest enterprises. One successful approach has been cobranding, in which California wines are bundled in packages of similar products, such as cheese and snacks, that are then sold to customers abroad. The total value of U.S. wine exports hovers near $1 billion per year and has been growing rapidly. But California wineries are being challenged in their home market by the exporting activities of cost-effective wine producers from countries like Australia, Chile, and South Africa.[8] The *Global Trend* feature describes how SMEs are increasingly active in exporting.

Disadvantages of Exporting

As an entry strategy, exporting also has some drawbacks. First, because exporting does not require the firm to have a physical presence in the foreign market (in con-

> GLOBAL TREND

The Emergence of SME Exporters

The role of small and medium-sized enterprises (SMEs) in exporting is growing. In the United States, SMEs have less than 500 employees, although the definition differs in Europe and elsewhere, where firms may have as few as 100 employees to qualify as SMEs. SMEs account for a great proportion of all U.S. exporters. From 1992 to 2004, they represented nearly 100 percent of the growth in the U.S. exporter population, swelling from about 108,000 firms in 1992 to over 225,000 firms by 2004. SMEs were responsible for nearly a third of merchandise exports from the United States in 2006. Most were wholesalers, distributors, and other nonmanufacturing firms.

In recent years, the national governments of Australia, Britain, Canada, China, New Zealand, and the United States have undertaken aggressive campaigns to help more SMEs become exporters. Governments sponsor trade fairs and trade missions that connect SMEs with distributors and other facilitators in promising foreign markets. The World Bank assists SME exporters from emerging markets by increasing access to capital and developing their international business skills. While most SMEs export to advanced economies, an increasing number of these firms target emerging markets. These firms do not necessarily require large export markets since they tend to cater to smaller market niches.

For example, Pharmed Group, based in Florida, is a full-line distributor of medical, surgical, and pharmaceutical supplies. Looking to further expand its export sales, the firm signed a deal with Drogao, a major drug store chain in Brazil. Export sales have contributed significantly to Pharmed's growth. Another SME, Optical Xport, exports optical lenses and frames to customers in West and Central Africa from its low-cost manufacturing base in Senegal. These efforts increase the flow of medical supplies and eyeglasses to the poor in Latin America and Africa.

SME exporters have certain advantages that differentiate them from larger and more experienced firms:

- *Flexibility*—the ability to rapidly adapt to foreign market opportunities.
- *Quick response*—faster decision making and implementation of new operating methods.
- *Customization*—the ability to customize products to foreign buyers, with greater ease and smaller production runs.
- *Risk-taking*—SME managers often have an entrepreneurial spirit, high-growth aspirations, and a strong determination to succeed.

SMEs bring these advantages to bear in markets worldwide. SMEs benefit numerous emerging markets, which typically lack access to a wide range of products and services.

Sources: Dahl, Darren. (2005). "Instantly International," *Inc.,* 27(6): 44; U.S. Department of Commerce at www.export.gov/comm_svc/press_room/news/articles; Neupert, Kent, C. Christopher Baughn, and T. Dao. (2006). "SME Exporting Challenges in Transitional and Developed Economies," *Journal of Small Business and Enterprise Development* 13(4): 535–44; Prahalad, C. K. (2004). "Why Selling to the Poor Makes for Good Business," *Fortune,* Nov. 15, pp. 70-71; U.S. Department of Commerce. (2004). *Exporter Database,* Washington, DC: U.S. Department of Commerce; World Bank. (2005). *2004 Annual Review: Small Business Activities.* Washington, DC: World Bank Group.

trast to FDI), management has fewer opportunities to learn about customers, competitors, and other unique aspects of the market. A lack of direct contact with foreign customers means that the exporter may fail to perceive opportunities and threats, or may not acquire the knowledge that it needs to succeed in the market in the long term.

Second, exporting usually requires the firm to acquire new capabilities and dedicate organizational resources to properly conduct export transactions. Firms that are serious about exporting must hire personnel with competency in international transactions and foreign languages. Exporting requires management to expend the time and effort to learn about freight forwarders, documentation, foreign currencies, and new financing methods. The acquisition of such capabilities puts a strain on firm resources.

Third, compared to other entry strategies, exporting is much more sensitive to tariff and other trade barriers, as well as fluctuations in exchange rates. For example, the U.S. dollar gained 12 percent against the euro and 15 percent against the yen in 2005. This led to slower growth of U.S. exports, harming those firms that rely heavily on exporting for generating international sales. Exporters run the risk of being priced out of foreign markets if shifting exchange rates make the exported product too costly to foreign buyers.

A Systematic Approach to Exporting

The more experienced managers use a systematic approach to improve the firm's prospects for successful exporting by assessing potential markets, organizing the firm to undertake exporting, acquiring appropriate skills and competencies, and implementing export operations. Exhibit 13.3 highlights the steps involved in this process. Let's examine each of these steps in detail.

Step One: Assess Global Market Opportunity As a first step, management assesses the various global market opportunities available to the firm. It analyzes the readiness of the firm and its products to carry out exporting. In this process, managers might employ a diagnostic tool such as *CORE* (*COmpany Readiness to Export*, available online at globalEDGE™). Management screens for the most attractive export markets, identifies qualified distributors and other foreign business partners, and estimates industry market potential and company sales potential. It is often useful for managers to visit the most promising countries to develop a deeper understanding of customer requirements, competitive environment, capabilities of intermediaries, and government regulations. Participating in foreign trade shows and trade missions is a practical means for identifying market potential and foreign intermediaries. We explained the global market opportunity assessment (GMOA) process in detail in Chapter 12.

Exhibit 13.3

A Systematic Approach to Exporting

SOURCE: Adapted from S. Tamer Cavusgil and Shaoming Zou, "Marketing Strategy-Performance Relationship: An Investigation of the Empirical Link in Export Market Ventures," *Journal of Marketing 58* (January 1994): 1–21.

Step Two: Organize for Exporting Next, managers address the following questions: What types of managerial, financial, and productive resources should the firm commit to exporting? What sort of a timetable should the firm follow for achieving export goals and objectives? To what degree should the firm rely on domestic and foreign intermediaries to implement exporting?

Exhibit 13.4 illustrates alternative organizational arrangements in exporting. **Indirect exporting** is accomplished by contracting with intermediaries located in the firm's home market. Smaller exporters, or those new to international business, typically hire an export management company (EMC) or a trading company based in the exporter's home country. These channel intermediaries assume responsibility for finding foreign buyers, shipping products, and getting paid. The principal advantage of indirect exporting for most firms is that it provides a way to penetrate foreign markets without the complexities and risks of more direct exporting. The novice international firm can start exporting with no incremental investment in fixed capital, low startup costs, and few risks, but with prospects for incremental sales.

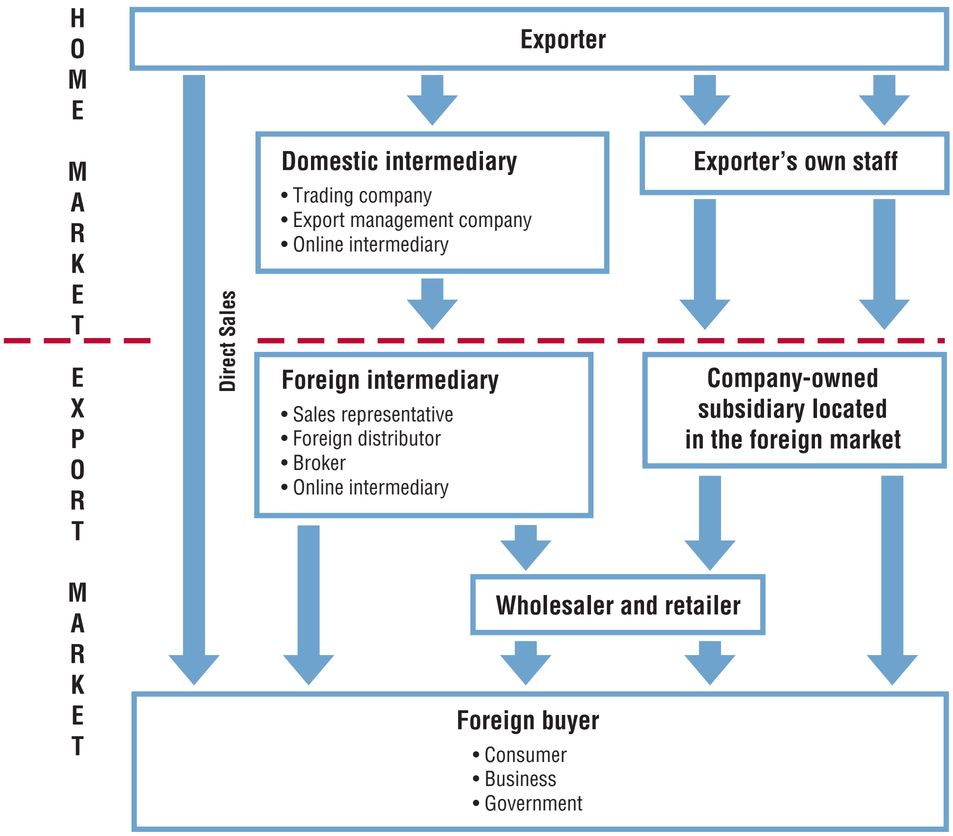
Indirect exporting Exporting that is accomplished by contracting with intermediaries located in the firm's home market.

By contrast, **direct exporting** is typically achieved by contracting with intermediaries located in the *foreign* market. The local intermediaries serve as an extension of the exporter, negotiating on behalf of the exporter and assuming such responsibilities as local supply-chain management, pricing, and customer service. Compared to indirect exporting, the main advantage of direct exporting is that it gives the exporter greater control over the export process and potential for higher profits, as well as allowing a closer relationship with foreign buyers and the marketplace. However, compared to indirect exporting, the exporter must dedicate more time, personnel, and corporate resources in developing and managing export operations.

Direct exporting Exporting that is accomplished by contracting with intermediaries located in the foreign market.

Exhibit 13.4

Alternative Organizational Arrangements for Exporting



Direct and indirect exporting are not mutually exclusive, and many firms use both approaches for different foreign markets. Key considerations for deciding whether to use indirect or direct exporting are: (1) the level of resources—mainly time, capital, and managerial expertise—that management is willing to commit to international expansion and individual markets; (2) the strategic importance of the foreign market; (3) the nature of the firm's products, including the need for after-sales support; and (4) the availability of capable foreign intermediaries in the target market.

Another exporting arrangement is for the firm to set up a sales office or a **company-owned subsidiary** that handles marketing, physical distribution, promotion, and customer service activities in the foreign market. In this arrangement, the firm undertakes major tasks directly in the foreign market, such as participating in trade fairs, conducting market research, searching for distributors, and finding and serving customers. Management may decide to pursue this route if the foreign market seems likely to generate a high volume of sales or has substantial strategic importance. Management may also elect to set up regional or national distribution centers and warehouses. At the extreme, the firm may establish a full-function marketing subsidiary, staffed with a local sales force. For instance, exports of Australia-based Webspy Company's internet software now make up 80 percent of the firm's annual revenue. Initially the firm exported exclusively through independent foreign distributors. But eventually Webspy established sales subsidiaries in London and Seattle to service its two most important regional markets, Europe and North America (www.austrade.gov.au).

Company-owned subsidiary
A representative office of the exporter that handles marketing, physical distribution, promotion, and customer service activities in the foreign market.

Step Three: Acquire Needed Skills and Competencies Export transactions are varied and often complex, requiring specialized skills and competencies. The firm may wish to launch new or adapted products abroad, target countries with varying marketing infrastructure, finance customer purchases, or contract with helpful facilitators at home and abroad. Accordingly, managers need to gain new, internationally oriented capabilities in areas such as product development, distribution, logistics, finance, contract law, and currency management. Managers may need to acquire foreign language skills and the ability to interact with customers from diverse cultures. Fortunately, numerous facilitators, such as those described in Chapter 3, are available to assist firms that lack specific skills and competencies.

Step Four: Implement Exporting Strategy In the final stage, management formulates elements of the firm's export strategy. *Product adaptation* involves modifying a product to make it fit the needs and tastes of the buyers in the target market. For example, when Microsoft markets computer software in Germany, it must ensure the software is written in German. Even Vellus, the firm discussed in the opening vignette, must vary the dog-grooming products that it sells abroad because U.S. exhibitors prefer dogs with poofed-out topknots while British exhibitors prefer less hair. The dog brushes and shampoos that Vellus sells in the United States may not sell in Britain. In export markets with many competitors, the exporter needs to adapt its products in order to gain competitive advantage.

Marketing communications adaptation refers to modifying advertising, selling style, public relations, and promotional activities to suit individual markets. Marketing communications activities are adapted depending on the nature of the target market, the nature of the product, the firm's position in the market relative to competitors, and management's specific goals and objectives. *Price competitiveness* refers to efforts to keep foreign pricing in line with that of competitors. In markets with many competitors, the exporter may need to charge competitive prices. However, SMEs often lack the resources to compete head-to-head on pricing with larger rivals. Such firms compete not by charging low prices, but by emphasizing the nonprice benefits of their products, such as quality, reliability, and brand leadership. *Distribution strategy* often hinges on developing strong and mutually beneficial relations with foreign intermediaries.[9] Companies provide ongoing support to distributors and subsidiaries in the form of sales force training, technical assistance, marketing know-how, promotional support, and pricing incentives. In markets with numerous competitors, the exporter may need to boost the capabilities of its distributors. If the product is technologically complex, the exporter may need to increase support to intermediaries to ensure they understand how to market and service the product.

Importing

Importing Buying of products and services from foreign sources and bringing them into the home market. Also referred to as global sourcing, global procurement, or global purchasing.

The counterpart of exporting is **importing**, in which the firm chooses to buy products and services from foreign sources and bring them into the home market. Firms that import, whether they are manufacturers, wholesalers, or retailers are called importers. Importing is also referred to as *global sourcing, global procurement,* or *global purchasing.* The sourcing may be from independent suppliers abroad or from company-owned subsidiaries or affiliates.

Many manufacturers and retailers are also major importers. Manufacturing companies tend to import raw materials and parts to go into assembly. Retailers secure a substantial portion of their merchandise from foreign suppliers. For example, in the United States, retailers such as Wal-Mart, Home Depot, and Target are among the largest importers. By itself, Wal-Mart accounts for about 10 percent of U.S. imports from China, amounting to about $20 billion per year. Other large importers include chemical companies (e.g., LG), electronics firms (e.g., Phillips), and food wholesalers (e.g. Chiquita Brands International).

The fundamentals discussed in this chapter regarding exporting, payments, and financing also apply to importing. Both importing and exporting—sometimes referred to collectively as *international trade*—require the firm to follow various complex procedures, often related to clearing products through domestic ports of entry. Successful exporting and importing necessitate careful management of the focal firm's global supply chain, that is, the firm's integrated network of sourcing, production, and distribution activities, organized on a world scale. As with exporting, most importers delegate much of the mechanics of importing to *facilitators,* the specialist firms such as freight forwarders and customs house brokers that we discussed in Chapter 3. Today, many manufacturers source input goods and services from foreign suppliers worldwide. We therefore devote a separate chapter, Chapter 16, to global sourcing.

Managing Export-Import Transactions

Skillful exporters develop the ability to conceive and carry out aggressive foreign market entry and meet the demands of day-to-day export operations. In the early phase of exporting, management establishes an export group or department represented by only an export manager and a few assistants. The export department is typically subordinate to the domestic sales department and depends on other units inside the firm to fulfill customer orders, receive payments, and organize logistics. Novice international firms prefer this minimalist approach because it requires only a limited commitment of corporate resources, a key consideration when management is unsure or hesitant about getting started in international business. Assuming the firm's early export efforts are successful, management is likely to increase its commitment to internationalization by developing a specialized export staff. In large, experienced exporters, management typically creates a separate export department, which can become fairly autonomous.

When comparing domestic and international business transactions, key differences arise in the areas of documentation and shipping.

Documentation

Documentation Official forms and other paperwork required in export transactions for shipping and customs procedures.

Documentation refers to the official forms and other paperwork that are required in export transactions for shipping and customs procedures. Initially, the exporter usually issues a *quotation* or *pro forma invoice* upon request by potential customers. This can be structured as a standard form, which informs the potential buyer about the price and description of the exporter's product or service. The *commercial invoice* is the actual demand for payment issued by the exporter when a sale is concluded. It includes a description of the goods, the exporter's address, delivery address, and payment terms. The exporter may also include a *packing list,* particularly for shipments that involve numerous goods, which indicates the exact contents of the shipment.

Firms typically distribute exported goods by ocean transport, although some firms use air transport. The *bill of lading* is the basic contract between exporter and shipper. It authorizes a shipping company to transport the goods to the buyer's destination. It also serves as the importer's receipt and proof of title for purchase of the goods. The shipper's *export declaration* (sometimes called "ex-dec") lists the contact information of the exporter and the buyer (or importer), as well as a full description, declared value, and destination of the products being shipped. National customs services and other port authorities use the export declaration to ascertain the content of shipments, to control exports, and to compile statistics of which goods are entering and leaving the country. The *certificate of origin* is the "birth certificate" of the goods being shipped and indicates the country where the product originates. Exporters usually purchase an *insurance certificate* to protect the exported goods against damage, loss, pilferage (theft), and, in some cases, delay.

Documentation must be completed in a precise manner. The types of documents required vary depending on regulations of both the home and destination countries. The exporter typically entrusts the preparation of documents to an international freight forwarder. As introduced in Chapter 3, freight forwarders are among the key facilitators in international business, functioning like travel agents for cargo. In addition to documentation, the typical freight forwarder is a specialist in international shipping methods and the international trade regulations of the home and target countries. The freight forwarder assists exporters with tactical and procedural aspects of exporting such as logistics, packing, and labeling. At the foreign port, the freight forwarder arranges to have exported products cleared through customs and shipped on to the buyer. After shipment, the freight forwarder routes documentation to the seller, the buyer, or to another facilitator, such as a bank.

Another important document is the *license,* a type of permission to export. National governments sometimes require exporters to obtain a license for reasons of national security, foreign policy, or because the exported product is in short supply. For example, governments usually don't allow firms to export nuclear materials or harmful biological agents that can be used to create weapons. In addition, some governments impose sanctions on trade with certain countries as part of their foreign policy. Lastly, governments may forbid the export of certain types of essential goods, such as petroleum products, if they are in short supply in the home country.

Export transactions frequently involve shipping products through seaports, such as this one in California.

Shipping and Incoterms

International shipping exposes the exporter's goods to adverse conditions and handling by various facilitators. The firm must comply with the laws and procedures specific to each market. Logistics personnel must make sure the product is packed carefully, so that it arrives in good condition at the distant target market. The shipment must be labeled correctly to ensure it is handled properly en route and arrives at the right place on time. The exporter must complete and send with the shipment the appropriate documentation that complies with regulations of the home and foreign governments.

Most export transactions involve products being shipped from the exporter's factory to a nearby seaport or airport. From there, the shipment is transported by ship or airplane to a foreign port, where it is transferred to land-based transportation and conveyed to the customer's final destination. Alternatively, in the case of shipments to neighboring countries, the exported product may be transported entirely via land-based means, such as rail or truck, to the customer's destination. Throughout the delivery process, the exporter incurs various transportation costs. In addition, the exported product is usually insured against damage or loss during transit.

In the past, disputes sometimes arose over who should pay the cost of freight and insurance in international transactions: the seller (that is, the exporter) or the foreign buyer. To eliminate such disputes, a system of universal, standard terms of sale and delivery, known as **Incoterms** (short for "International Commerce Terms") have been developed by the International Chamber of Commerce (http://www.iccwbo.org). Commonly used in international sales contracts, Incoterms specify how the buyer and the seller share the cost of freight and insurance, and at which point the buyer takes title to the goods. Exhibit 13.5 illustrates the implications of the three most commonly used Incoterms.

Incoterms Universally accepted terms of sale that specify how the buyer and the seller share the cost of freight and insurance in an international transaction, and at which point the buyer takes title to the goods.

Methods of Payment in Exporting and Importing

Receiving payment for products sold is more complicated in international business than in domestic business. Foreign currencies may be unstable, and/or governments may be reluctant to allow funds to leave the country. In the event of disputes over payment, local laws and enforcement mechanisms may favor local citizens over foreign firms. Some customers in developing countries lack payment mechanisms such as credit cards and checking accounts. In short, getting paid in international business entails risks and potentially complex payment methods.

In countries with advanced economies, firms often extend credit to buyers with the assurance they will be paid. It is typical for exporters to allow customers in such markets several months to make payments or to structure payment on *open account.* If payment is not forthcoming, a legal system is usually in place to compel creditors to meet their obligations. By contrast, in many emerging markets and developing countries, exporters extend credit cautiously. They evaluate new customers carefully and may decline a customer's request for credit if the risk is too great.

Fortunately, there are several conventional methods for getting paid in international business. Listed roughly in order of most secure to least secure from the exporter's standpoint, these methods are: *cash in advance, letter of credit, open account, consignment,* and *countertrade.* While the last method, countertrade, can

Incoterms	*Definition*	*Key points*	*Arrangement of shipping*
EXW Ex works (named place)	Delivery takes place at the seller's premises or another named place (i.e., works, factory, or warehouse). Shipment is not cleared for export and not loaded on any collecting vehicle.	EXW represents minimum obligation for the seller; the buyer bears all costs and risks involved in claiming the goods from the seller's premises.	Buyer arranges shipping.
FOB Free on board (named port of shipment)	Delivery takes place when the goods pass the ship's rail at the named port of shipment.	The buyer bears all the costs and risks of loss or damage upon delivery. The seller clears the goods for export. This term is used only for sea and inland waterway transport.	Buyer arranges shipping.
CIF Cost, insurance and freight (named port of destination)	Delivery takes place when the goods pass the ship's rail in the port of shipment.	The seller must pay for insurance and freight necessary to bring the goods to the named port of destination. At that point, the risk of loss or damage to the goods is transferred from the seller to the buyer. The seller clears the goods for export.	Seller arranges shipping and insurance.

Exhibit 13.5 Incoterms: Examples of How Transport Obligations, Costs, and Risks are Shared between the Buyer and the Seller

SOURCE: International Chamber of Commerce, http://www.iccwbo.org

serve as a method of payment in international business transactions, it is also a distinct form of foreign market entry that deserves extensive treatment. Therefore, we discuss it separately in this chapter. We explain each of the other four payment methods next.

Cash in Advance

When the exporter receives cash in advance, payment is collected before the goods are shipped to the customer. The main advantage is that the exporter need not worry about collection problems and can access the funds almost immediately upon concluding the sale. Many exporters accept credit cards as payment, especially for low-value sales. From the buyer's standpoint, however, cash in advance is risky and may cause cash flow problems. The buyer may hesitate to pay cash in advance for fear the exporter will not follow through with shipment, particularly if the buyer does not know the exporter well. For these reasons, cash in advance is unpopular with foreign buyers and tends to discourage sales. Exporters who insist on cash in advance tend to lose out to competitors who offer more flexible payment terms.

Letter of Credit

Letter of credit Contract between the banks of a buyer and a seller that ensures payment from the buyer to the seller upon receiving an export shipment.

A documentary letter of credit, or simply a *letter of credit*, resolves some of the problems associated with cash in advance. Because a letter of credit protects the interests of both the seller and the buyer simultaneously, it has become the most popular method for getting paid in export transactions. Essentially, a **letter of credit** is a contract between the banks of the buyer and seller that ensures payment from the buyer to the seller upon receiving an export shipment. It amounts to a substitution of each bank's name and credit for the name and credit of the buyer and seller. The system works because virtually all banks have established relationships with correspondent banks around the world.

A letter of credit may be either *irrevocable* or *revocable*. Once established, an irrevocable letter of credit cannot be canceled without agreement of both buyer and seller. The selling firm will be paid as long as it fulfills its part of the agreement. As a bonus, the letter of credit immediately establishes trust between buyer and seller. Among the countless firms that use letters of credit is Pinewood Healthcare, a manufacturer of generic pharmaceuticals. Exports account for 70 percent of Pinewood's sales. When Pinewood first started exporting to Africa, the firm sometimes experienced difficulties in getting paid. The situation improved greatly when it began contracting sales via letter of credit.[10]

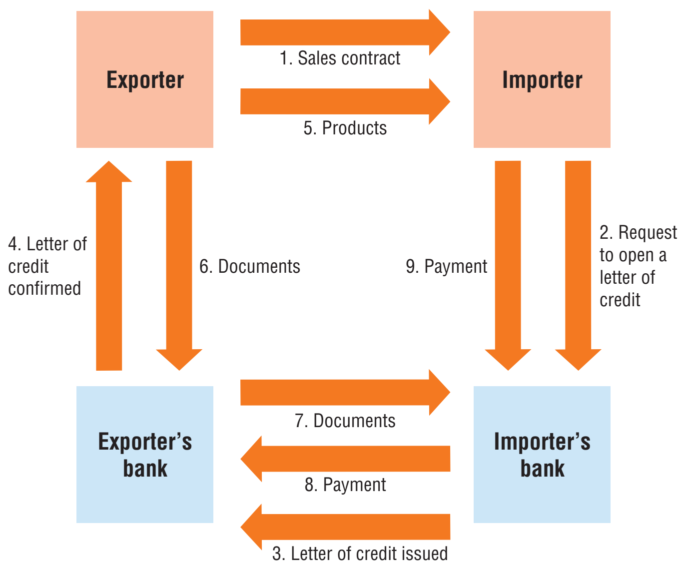
The letter of credit also specifies the documents the exporter is required to present, such as a bill of lading, commercial invoice, and a certificate of insurance. Before making a payment, the buyer's bank verifies that all documents meet the requirements the buyer and seller agreed to in the letter of credit. If not, the discrepancy must be resolved before the bank makes the payment.

Exhibit 13.6 presents the typical cycle of an international sale through a letter of credit.

1. An "Exporter" signs a contract for the sale of products to a foreign buyer, the "Importer."
2. The Importer requests its bank (the "Importer's Bank") to open a letter of credit in favor of the Exporter, the beneficiary of the credit.
3. The Importer's Bank notifies the "Exporter's Bank" that a letter of credit has been issued.

Exhibit 13.6

Letter of Credit Cycle



4. The Exporter's Bank confirms the validity of the letter of credit.
5. The Exporter prepares and ships the products to the Importer as specified in the letter of credit.
6. The Exporter presents the shipment documents to its bank, the Exporter's Bank, which examines them to ensure they fully comply with the terms of the letter of credit. The documents typically include an invoice, bill of lading, and insurance certificate, as specified in the letter of credit.
7. The Exporter's Bank sends the documents to the Importer's Bank, which similarly examines them to ensure they comply fully with the letter of credit.
8. Upon confirmation that everything is in order, the Importer's Bank makes full payment for the goods to the Exporter, via the Exporter's Bank.
9. The Importer makes full payment to its bank within the time period granted to it, which, in many countries, can extend to several months.

A related payment method is the *draft.* Similar to a check, the draft is a financial instrument that instructs a bank to pay a specific amount of a specific currency to the bearer on demand or at a future date. For both letters of credit and drafts, the buyer must make payment upon presentation of documents that convey title to the purchased goods, and confirm that specific steps have been taken to prepare the goods and their shipment to the buyer. Letters of credit and drafts can be paid immediately or at a later date. Drafts that are paid upon presentation are called *sight drafts.* Drafts that are to be paid at a later date, often after the buyer receives the goods, are called *time drafts* or *date drafts.* In addition, the exporter can sell any drafts and letters of credit in its possession via discounting and forfeiting to financial institutions that specialize in such instruments. Exporters do this in order to avoid having to wait weeks or months to be paid for their exports.

Open Account

When the exporter uses an *open account*, the buyer pays the exporter at some future time following receipt of the goods, in much the same way that a retail customer pays a department store on account for products he or she has purchased. Because of the risk involved, exporters use this approach only with customers of long standing or with excellent credit or a subsidiary owned by the exporter. With an open account, the exporter simply bills the customer, who is expected to pay under agreed terms at some future time. Many large MNEs make purchases only on open account. However, the lack of documents and banking channels that the exporter would normally use if selling via letters of credit can make it difficult to have claims enforced legally. The exporter might also have to pursue collection abroad (that is, undertake a legal procedure to collect its debt), which can be difficult and costly.

Consignment Sales

Under a *consignment sale,* the exporter ships products to a foreign intermediary who then sells them on behalf of the exporter. The exporter retains title to the goods until they are sold, at which point the intermediary or foreign customer owes payment to the exporter. The disadvantage of this approach is that the exporter maintains very little control over the products. The exporter may not receive payment for some time after delivery, or not at all. Thus, exporters that conduct consignment sales often carry risk insurance. Consignment sales work best when the exporter has an established relationship with a trustworthy distributor.

Cost and Sources of Export-Import Financing

The ability to finance a sale is often a factor that differentiates successful exporters from other firms. If a competitor offers better terms for a similar product, the exporter may lose sales. The ability to offer attractive payment terms is often necessary to generate sales. Four key factors determine the cost of financing for export sales.

First is the *creditworthiness of the exporter.* Firms with little collateral, minimal international experience, or those that receive large export orders that exceed their manufacturing capacity may encounter much difficulty in obtaining financing from banks and other lenders at reasonable interest rates, or may not receive financing at all. Second, *creditworthiness of the importer* is a determining factor. An export sales transaction often hinges on the ability of the buyer to obtain sufficient funds to purchase the goods. Some buyers, particularly those from developing economies or countries with currency controls, may be unable to secure financing through letters of credit.

Third is the *riskiness of the sale.* International sales are usually more risky than domestic ones. Banks are reluctant to loan funds for risky sales. Even when funds are provided, financing institutions tend to expect a higher return on loans for risky projects. Riskiness is a function of the value and marketability of the good being sold, the extent of uncertainty surrounding the sale, the degree of political and economic stability in the buyer's country, and the likelihood that the loan will be repaid.

Finally, the *timing of the sale* influences the cost of financing. In international trade, the exporter usually wants to be paid as soon as possible, while the buyer prefers to delay payment, especially until it has received or resold the goods. In some industries, the length of time to complete a sale may be considerable. A common challenge arises when the firm receives an unusually large order from a foreign buyer. In this case, the exporter needs to draw on substantial working capital to initiate and conclude production of the order. This is particularly burdensome for resource-constrained SMEs. In addition, payment periods in international sales are often long, frequently extending over several months.

These four factors strongly influence the availability and cost of funds. Ultimately, the cost of financing affects the pricing and profitability of a sale as well as the payment terms the exporter can offer the buyer. Fortunately, there are various sources for financing international sales, which we discuss next.

Commercial Banks

The same commercial banks used to finance domestic activities can often finance export sales. A logical first step for the exporter that needs financing is to approach the local commercial bank with which it already does business. Alternatively, the exporter may approach a commercial bank with an international department. Such banks are familiar with exporting and may also provide international banking services such as letters of credit. Another option is to have the bank make a loan directly to the foreign buyer to finance the sale. Such loans are available for well-established foreign buyers in stable markets.

Factoring, Forfaiting, and Confirming

Factoring is the discounting of a foreign account receivable by transferring title of the sold item and its account receivable to a *factoring house* (an organization that specializes in purchasing accounts receivable) for cash at a discount from the face value. *Forfaiting* is the selling, at a discount, of long-term accounts receivable of the seller or promissory notes of the foreign buyer. There are numerous *forfaiting houses,* companies that specialize in this practice. *Confirming* is a financial service in which an independent company confirms an export order in the seller's country and makes payment for the goods in the currency of that country. For the exporter, confirming means that the entire export transaction from plant to end user can be fully coordinated and paid for over time. Although used by many exporting firms, these financing options are less widely available than commercial bank financing.

Distribution Channel Intermediaries

In addition to acting as export representatives, some intermediaries may finance export sales. For example, many trading companies and export management companies provide short-term financing or may simply purchase products for export directly from the manufacturer, thus eliminating any risks associated with the export transaction as well as the need for financing.

Buyers and Suppliers

Foreign buyers of expensive products often make down payments that reduce the need for financing from other sources. In addition, buyers may make incremental payments as production of the goods or project is completed. Some industries use letters of credit that allow for progress payments upon inspection by the buyer's agent or receipt of a statement by the exporter that a certain percentage of the product has been completed. In addition, vendors from whom the exporter buys input goods or supplies may be willing to offer more favorable payment terms to the exporter if they are confident they will receive payment.

Intracorporate Financing

Large multinational enterprises with foreign subsidiaries have many more options for financing exports. For instance, the MNE may allow its subsidiary to retain a higher-than-usual level of its own profits, in order to finance export sales. The parent firm may provide loans, equity investments, and trade credit (such as extensions on accounts payable) as funding for the international selling activities of its subsidiaries. The parent can also guarantee loans obtained from foreign banks by its subsidiaries. Finally, large MNEs can often access equity financing by selling corporate bonds or shares in stock markets.

Government Assistance Programs

Most government agencies offer programs to assist exporters with their financing needs. These programs sometimes require that the exported goods contain substantial local content. Some programs provide loans or grants to the exporter, while others offer guarantee programs that require the participation of a bank or other approved lender. Commercial banks use government guarantee and insurance programs to reduce the risk associated with loans to exporters. Under such arrangements, the government pledges to repay a loan made by a commercial bank in the event the importer is unable to repay.

In the United States, the *Export-Import Bank* (Ex-Im Bank) is a government agency that has numerous programs to assist exporters. The bank issues credit insurance that protects firms against default on exports sold under short-term credit. Financing is available for exports, imports, and international investments. In addition, there are agencies that serve the needs of small exporters. For instance, the *U.S. Small Business Administration* helps firms that otherwise might be unable to obtain trade financing. Canada's Export Credits Insurance Corporation, India's Export Credit & Guarantee Corporation, Ltd., and Argentina's Compania Argentina de Seguros de Credito, perform services comparable to those of the Ex-Im Bank.

Multilateral Development Banks (MDBs)

Multilateral Development Banks (MDBs) International financial institutions owned by multiple governments within world regions or other groups.

Multilateral Development Banks (MDBs) are international financial institutions owned by multiple governments within world regions or other groups. Their individual and collective objective is to promote economic and social progress in their member countries—many of which are developing countries. MDBs include the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, and the World Bank Group. These institutions fulfill their missions by providing loans, technical cooperation, grants, capital investment, and other types of assistance to governments and agencies in the member countries.

Identifying and Working with Foreign Intermediaries

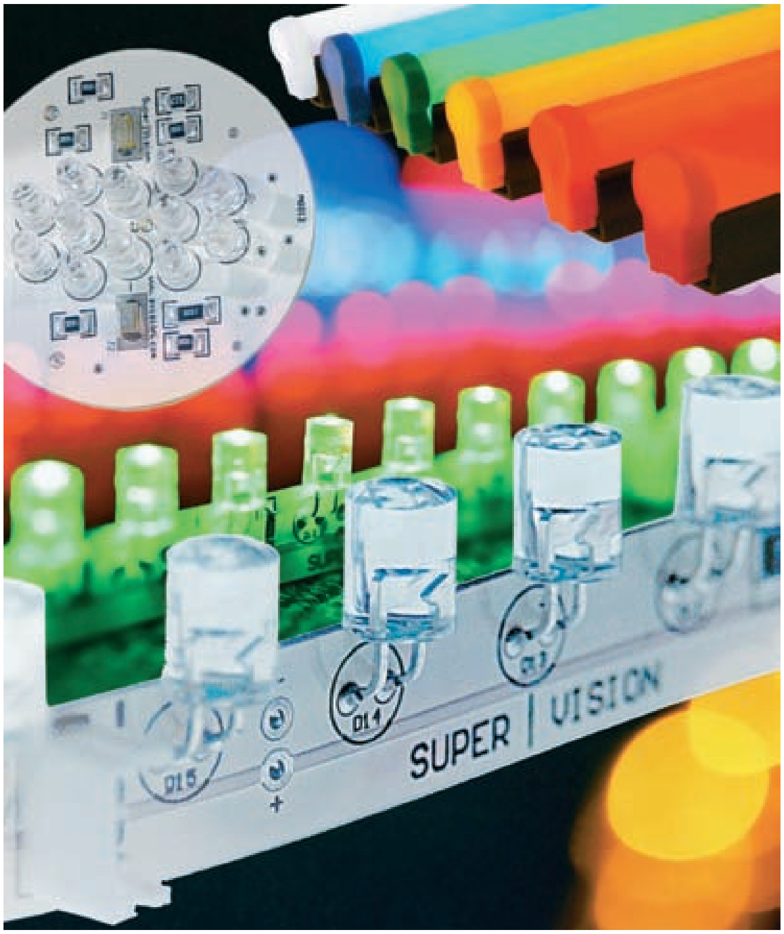
As the opening vignette emphasizes, success in exporting usually depends on establishing strong relationships with distributors, sales representatives, and other intermediaries in foreign markets. Trade fairs are a good way to meet potential intermediaries, become familiar with key players in the industry, and pick the brains of old hands—that is, other exporters experienced in the foreign market. In addition, firms may obtain recommendations on appropriate intermediaries from freight forwarders and trade consultants. In other cases, when attempting to find suitable foreign intermediaries, exporters may consult the following sources:

- Country and regional business directories, such as *Kompass* (Europe), *Bottin International* (worldwide), *Nordisk Handelskelander* (Scandinavia), and the *Japanese Trade Directory*. Other directories include: Dun and Bradstreet, Reuben H. Donnelly, Kelly's Directory, and Johnson Publishing, as well as foreign *Yellow Pages* (often available online).
- Trade associations that support specific industries, such as the National Furniture Manufacturers Association or the National Association of Automotive Parts Manufacturers.
- Government departments, ministries, and agencies charged with assisting economic and trade development, such as Austrade in Australia, Export Development Canada, and the International Trade Administration of the U.S. Department of Commerce.
- Commercial attachés in embassies and consulates abroad.
- Branch offices of certain foreign government agencies located in the exporter's country, such as JETRO, the Japan External Trade Organization.

Often, the best method for managers to identify and qualify intermediaries is to visit the target market. On-site visits afford managers direct exposure to the market and opportunities to meet prospective intermediaries. Managers can also inspect the facilities as well as gauge the capabilities, technical personnel, and sales capabilities of prospective intermediaries. Once the choices have been narrowed to one or two intermediary candidates, experienced exporters often request a prospective intermediary to prepare a business plan for the proposed venture. The quality and sophistication of the resulting plan provides a basis for judging the true capabilities of the prospective partner.

Working with Foreign Intermediaries

In Chapter 3, we discussed the nature and role of various intermediaries in international business. In exporting, the most typical intermediary is the foreign-based independent distributor. The exporter relies on the distributor for much of the marketing, physical distribution, and customer service activities in the export market. The exporter's success greatly depends on the capabilities that the distributor brings to the venture. Therefore, effective managers go to great lengths to build *relational assets*—that is, high-quality, enduring business and social relationships with key intermediaries and facilitators abroad that provide competitive advantages. For instance, Sharon Doherty (in the opening vignette) succeeded in exporting by developing close relationships with qualified foreign distributors. While competitors can usually replicate the exporter's other competitive attributes, such as product features or marketing skills, strong ties with competent foreign intermediaries are built over time, and provide the exporter with an enduring competitive advantage.



Working closely with foreign intermediaries has helped fiber-optic lighting manufacturer Super Vision International Inc. earn significant revenue from abroad.

Developing relational assets with intermediaries is accomplished in various ways. The exporter can cultivate mutually beneficial, bonding relations; display genuine response to the intermediary's needs; and build solidarity with the partner, by demonstrating solid commitment, remaining reliable, and building trust.[11] As an example, Super Vision International Inc. is a manufacturer of fiber-optic lighting. When exporting to a particular country, Super Vision initially develops a close working relationship with the country's top importer, which then becomes Super Vision's conduit to smaller companies in the country. The recipe seems successful: Super Vision now receives two-thirds of its revenues from abroad, much of it from developing countries.[12]

To create a positive working relationship, the exporter should be sensitive to the intermediary's objectives and aspirations. This requires developing a good understanding of the intermediary's needs and working in earnest to address those needs. In general, foreign intermediaries expect exporters to provide the following:

- Good, reliable products, and those for which there is a ready market
- Products that provide significant profits
- Opportunities to handle other product lines
- Support for marketing communications, such as advertising and promotions, and product warranties
- A payment method that does not unduly burden the intermediary
- Training for intermediary personnel and the opportunity to visit the exporter's facilities (at the exporter's expense), to gain first-hand knowledge of the exporter's operations
- Help establishing after-sales service facilities, including training of local technical representatives and allowances for the cost of replacing defective parts, as well as a ready supply of spare parts, to maintain or repair the products.

Meeting these expectations goes a long way in creating mutually beneficial, long-term relationships.

In turn, the exporter has expectations that its intermediaries should ideally meet. Since relationships with foreign intermediaries are so critical to the exporter's

Intermediary dimension	*Evaluation criteria*
Strengths	• Ability to finance initial sales and subsequent growth in the market • Ability to provide financing to customers • Quality of management team • Reputation among current and past customers • Connections with influential people or government agencies in the market
Product factors	• Familiarity with the exporter's product • Quality and sophistication of all product lines handled by the intermediary • Ability to ensure security for patents and other intellectual property rights • Willingness to drop competing product lines
Marketing skills	• Experience with target customers • Extent of geographic coverage provided in the target market • Quality and quantity of sales force • Ability to formulate and implement marketing plans
Commitment	• Percent of intermediary's business accounted by a single supplier • Willingness to maintain inventory sufficient to fully serve the market • Commitment to achieving minimum sales targets

Exhibit 13.7 Criteria for Evaluating Export Intermediaries

SOURCE: From S. Tamer Cavusgil, Poh-Lin Yeoh, and Michel Mitri (1995), "Selecting Foreign Distributors: An Expert Systems Approach," *Industrial Marketing Management*, 24 (4) pp. 298–304. Copyright © 1995, with permission from Elsevier.

success, experienced exporters implement a careful screening and selection process when first appointing distributors. Exhibit 13.7 summarizes the selection criteria that experienced exporters use to qualify prospective intermediaries.

When Intermediary Relations Go Bad

Despite good intentions, disputes can arise between the exporter and its intermediaries. Disputes may involve such issues as:

- Compensation arrangements (for example, the intermediary may wish to be compensated even if it were not directly responsible for generating a particular sales order in its territory)
- Pricing practices of the exporter's products
- Advertising and promotion practices, and the extent of advertising support expected from the manufacturer
- After-sales servicing for customers
- Policies on the return of products to the exporter
- Maintaining an adequate level of inventories
- Incentives for promoting new products
- Adapting the product for local customers

In anticipation of such disagreements, many exporters establish a contract-based, legal relationship with the partner. These exporters require the intermediary to sign a contract that binds the intermediary to achieve certain performance objectives and handle the product in a specified manner. Some firms require candidate intermediaries to undergo a courtship or probationary period during which they evaluate the intermediary's performance. At the end of the trial period, if the intermediary's performance is suboptimal or if disputes appear likely to emerge, the exporter may terminate the relationship or require the intermediary to enter a strict contractual relationship.

If the exporter decides to enter into a formal relationship with the intermediary, it must negotiate a contractual agreement that clarifies the tasks and responsibilities of both parties, specifies the duration of the relationship and the terms for its renewal, defines the intermediary's sales territory, and explains the resolution process for potential disputes. The agreement also describes the grounds and terms for terminating the intermediary. For instance, exporters typically terminate their intermediaries if the latter fall short of performance requirements, such as annual sales targets specified by the exporter. The intermediary, for its part, may ask for compensation in the form of indemnities in the event of termination.

Exporters must negotiate intermediary contracts with great care. The exporter needs to ascertain the legal requirements for termination in advance, and include contractual provisions that specify the intermediary's rights for compensation. In many countries, commercial regulations favor local intermediaries and may require the exporter to indemnify the distributor—that is, compensate the intermediary even if it can provide just cause for termination. In some countries, legal contracts may prove insufficient to protect the exporter's interests. For example, China and Russia lack strong legal institutional frameworks, which can make contracts hard to enforce.

Just as in the firm's domestic operations, exporters occasionally encounter problems with buyers or intermediaries who default on payment. As a rule, problems with bad debt are easier to *avoid* than to correct after they occur. Before entering an agreement, the exporter should perform a credit and other background check on potential intermediaries and large-scale buyers. In terms of payment mechanisms, cash in advance or a letter of credit is usually best. In addition to ensuring payment, the letter of credit encourages a high degree of trust between buyer and seller. The exporter can also buy insurance from insurance companies specialized in international transactions to cover commercial credit risks.

In all events, eventually some buyers default on payment. When this happens, the exporter's simplest and least costly recourse is to negotiate with the offending party. With patience, understanding, and flexibility, conflicts can often be resolved to the satisfaction of both sides. Although compromise may be required on certain points—perhaps even on the price of the committed goods—the exporter can save a valuable customer or intermediary, and profit in the long run. But if negotiations fail and the cost of termination is substantial, the exporter may need to seek assistance from its bank, legal counsel, and other qualified experts. At the extreme, the exporter may be forced to pursue litigation, arbitration, or other legal means for enforcing payment on a sale.

Countertrade

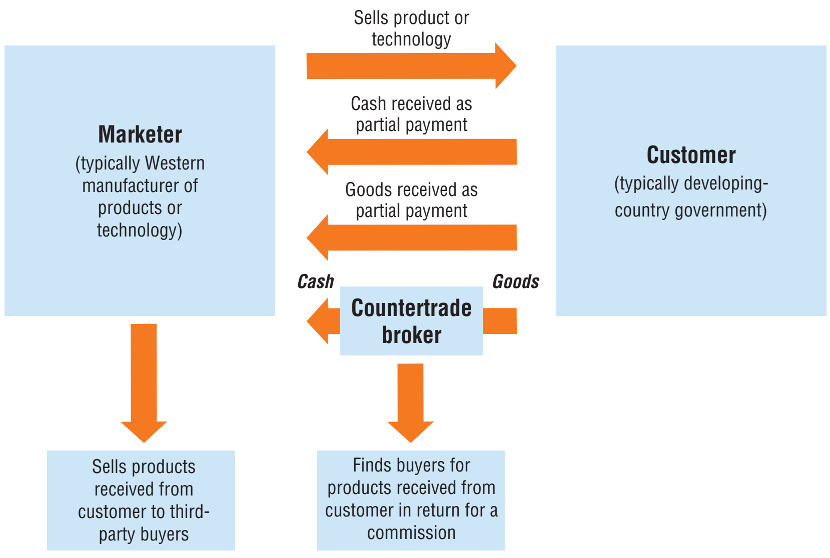
While countertrade can serve as a method of payment in international trade, it is also a distinct form of foreign market entry. Countertrade activities are especially prevalent in dealing with developing-country governments. Goods and services are traded for other goods and services when conventional means of payment are difficult, costly, or nonexistent. Thus, barter is a form of countertrade. Countertrade refers to an international business transaction where all or partial payments are made in kind rather than cash. The focal firm is engaged simultaneously in exporting and importing.

Consider the example of Caterpillar, which exported earth-moving equipment to Venezuela. In exchange, the Venezuelan government gave Caterpillar 350,000 tons of iron ore. Middle Eastern countries occasionally pay for imported goods with crude oil, as when Saudi Arabia purchased jets from Boeing. Also called *two-way* or *reciprocal* trade, countertrade operates on the principle of "I'll buy your products if you'll buy mine."

Exhibit 13.8 illustrates the multiple transactions involved in countertrade deals. Typically, the focal firm is a Western company, say General Electric, which

Exhibit 13.8

A Countertrade Transaction Where Products Are Received from the Customer as Partial or Full Payment



wishes to sell its products or technology (for example, jet engines) to a developing-country government. In a particular instance, the customer, the Indonesian government, was experiencing an acute shortage of convertible currencies (for example, the U.S. dollar, the euro, the yen) and was unable to pay General Electric in cash. The Indonesian government then asked General Electric to accept some local products as partial payment or in full. Typically the products developing countries offer are commodities (for example, agricultural grains, minerals, or manufactured products that may have limited international sales potential). General Electric may then agree to take these products and sell them in international markets in order to get paid. Alternatively, General Electric may ask a countertrade broker to sell these developing-country goods on its behalf, in return for a commission. In another countertrade deal, Philip Morris exported cigarettes to Russia for which it received industrial chemicals as payment. It shipped these chemicals to China and received glassware in exchange that it then sold for cash in North America. In addition to a buyer and a seller, a countertrade broker may also be involved. Multiple transactions also may take years to complete. As you can see, countertrade transactions tend to be much more complicated than conventional cash-for-goods trade.

Here are some other examples of countertrade transactions:

- Caterpillar received caskets from Columbian customers and wine from Algerian customers in return for selling them earthmoving equipment.
- Goodyear traded tires for minerals, textiles, and agricultural products.
- Coca-Cola sourced tomato paste from Turkey, oranges from Egypt, and beer from Poland in order to contribute to national exports in the countries it conducts business.
- Control Data Corporation accepted Christmas cards from the Russians in a countertrade deal.
- Pepsi-Cola acquired the rights to distribute Hungarian motion pictures in the West in a countertrade transaction.

The Magnitude and Drivers of Countertrade

Many MNEs have been pursuing nontraditional trade deals since the 1960s, not only in developing countries that lack hard currencies, but also in industrialized nations. While the exact extent of countertrade is unknown, some observers estimate that it accounts for as much as one-third of all world trade. Countertrade deals are also more prevalent in large-scale government procurement projects. For example, countertrade has been mandatory for all Australian federal government foreign purchases of more than 2.5 million Australian dollars. In South Korea, countertrade is mandated for government telecommunications and defense procurement exceeding $1 million. In Asia, Indonesia led the way early by requiring countertrade for large-scale public sector purchases. Eastern European nations and Russia have practiced barter and countertrade transactions for quite some time.

Countertrade occurs in response to two primary factors. First is the chronic shortage of hard currency in developing economies. Second is the lack of marketing expertise, adequate quality standards, and knowledge of western markets by developing-economy enterprises. Countertrade enables these enterprises to access markets that might otherwise be inaccessible, and at the same time generate hard currency.

Types of Countertrade

There are four main types of countertrade: barter, compensation deals, counterpurchase, and buy-back agreements. First, **barter**—the oldest form of trade—refers to the direct exchange of goods without any money. Though less common today, barter is still exercised (even in domestic trade) in straightforward, one-shot deals. Compared to the other forms of countertrade, barter involves a single contract (rather than two or more contracts typical of other forms), has a short time span (other countertrade deals may stretch over several years), and is less complicated (other forms generally require managerial commitment and resources are required in countertrade).

Barter A type of countertrade that involves the direct exchange of goods without any money.

Second, **compensation deals** involve payment both in goods and cash. For example, a company may sell its equipment to the government of Brazil and receive half the payment in hard currency and the other half in merchandise.

Compensation deals A type of countertrade that involves payment both in goods and cash.

Third, also known as a back-to-back transaction or offset agreements, **counterpurchase** involves two distinct contracts. In the first contract, the seller agrees to sell its product at a set price and receives cash payment from the buyer. However, this first deal is contingent on a second contract wherein the seller also agrees to purchase goods from the buyer for the total monetary amount or a set percentage of same. If the exchange is not of equal value, partial payment may be made in cash. Alternatively, the buyer may require that a certain proportion of the seller's goods be produced and assembled in the buyer's country. Counterpurchase is common in the defense industry, where the governments that purchase military hardware may require the defense contractor to purchase some local products or contribute to local employment.

Counterpurchase A type of countertrade that involves two distinct contracts. In the first contract, the seller agrees to sell its product at a set price and receives cash payment from the buyer. This first deal is contingent on a second contract wherein the seller also agrees to purchase goods from the buyer for the total monetary amount or a set percentage of same.

Finally, in a product **buy-back agreement**, the seller agrees to supply technology or equipment to construct a facility and receives payment in the form of goods produced by the facility. For example, the seller might design and construct a factory in the buyer's country to manufacture tractors. The seller is compensated by receiving finished tractors from the factory it built, which it then sells in world markets. In essence, the original transaction involves goods and services that produce other goods and services, which are then received in payment. Product buy-back agreements may require several years to complete and therefore entail substantial risk.

Buy-back agreement A type of countertrade that involves the seller agreeing to supply technology or equipment to construct a facility and receives payment in the form of goods produced by the facility.

Risks of Countertrade

There are four problems firms can encounter in reciprocal trade.

First, the goods that the customer offers may be inferior in quality, with limited potential to sell them in international markets.

Second, it is often very difficult to put a market value on goods the customer offers, because these goods are typically commodities or low-quality manufactured products. In addition, the buyer may not always have the opportunity to inspect the goods or have time to conduct a market analysis.

Third, countertrade deals are inefficient because both parties pad their prices. The seller may experience considerable difficulty in re-selling the commodities that it receives as payment. In a typical scenario, General Electric (GE) will place the products it receives as payment in countertrade (e.g., nails, furniture, tomato paste) with a broker who then sells them in world markets for a commission. Consequently, General Electric will build in the cost of disposing of the goods into the price that it quotes to the buyer. The buyer, in turn, anticipating GE's price padding, will pass the extra cost onto its customers. Thus, the resulting transaction between GE and the buyer is inefficient.

Fourth, reciprocal trade amounts to highly complex, cumbersome, and time-consuming transactions. As a result, the proportion of countertrade deals that firms are able to bring to fruition is often quite low. Fifth, rules imposed by governments can make countertrade highly bureaucratic. The rules essentially become cumbersome and often frustrating for the exporting firm.

Why Countertrade?

Although most firms are reluctant to engage in reciprocal trade, there are five circumstances when they would consider it. First, when the alternative is no trade at all, as in the case of mandated countertrade, firms will have to consider countertrade. Second, countertrade may help firms get a foothold in new markets and help them cultivate new customer relationships. For example, in the mining industry, certain types of minerals are available only in developing countries. Mining rights in these areas may be available only to firms willing to countertrade. Third, many companies use countertrade creatively to develop new sources of supply. Reciprocal trade is made more attractive if the company can secure products it would use in its own operations. The firm may develop new suppliers in the process.

Fourth, firms have used countertrade as a way of repatriating profits frozen in a foreign subsidiary operation's blocked accounts. Otherwise unable to repatriate its earnings, the firm will scout the local market for products it can successfully export to world markets. General Motors' former Motors Trading subsidiary was created to generate trade credits—that is, sell its vehicles in a market in return for contributing to exports of merchandise originating from that country.

Fifth, given their risky and cumbersome nature, firms may succeed in developing managers who are comfortable with a trading mentality. Multinational enterprises such as GM, GE, Siemens, Toshiba, and Caterpillar have set up separate divisions to foster global managers with a trading mentality, thereby becoming entrepreneurial, innovative, politically connected, and highly knowledgeable about a range of commodities and tradable goods. These firms recognize the value of such attributes for pursuing international deals and attempt to foster them by involving their global managers in countertrade. The skills that managers acquire contribute to international performance, not only in countertrade deals, but in various other cross-border transactions as well.

CLOSING CASE

Barrett Farm Foods: A Small Firm's International Launch

Philip Austin, general manager of Barrett Farm Foods, was thrilled after returning from the food industry trade fair in Cologne, Germany—the largest food and beverage fair in the world. Barrett Farm Foods, based in Melbourne, Victoria, is Australia's sixth largest food company. It distributes both bulk agricultural commodities and processed food products. Among others, it sells macadamia nuts, cereal bars, garlic, ginger, dried fruits, and honey throughout Australia. Barrett has had a healthy rate of growth over the past decade, and its sales reached US$215 million last year. While Barrett is well known in the domestic market, its international experience has been limited to responding to occasional, unsolicited orders from foreign customers. In completing these export orders, Barrett has relied on intermediaries in Australia that provided assistance to international logistics and payments. Yet Austin is enthusiastic about substantially expanding the export business over the next few years.

Recognizing an Opportunity

What prompted Mr. Austin to attend the Cologne fair was a recent report from Austrade, the Australian government's trade promotion agency, which highlighted the tremendous potential of Australian exports of foodstuffs. For example, According to Austrade, Australian food exports exceeded AU$25 billion last year. Austrade believes that highly processed foodstuffs are the coming trend and wants to boost their exports.

But this raises a dilemma: much of current exports are primarily raw foods, not *processed* foods. If just 10 percent of processed food value-adding were done in Australia, the country's balance of trade would improve. For example, instead of exporting raw grains to Europe, Austrade wants Australian producers to process the grains into bread and other bakery products, thereby creating jobs for Australians. Austrade believes that meat, cereal, sugar, dairy commodities, and marine products have the most potential for food processing.

Meeting with Potential Export Customers at the Cologne Fair

At the Cologne fair, Barrett's nut- and honey-based cereal bars and butter-like spread were a hit. Luigi Cairati, a senior executive with the Italian supermarket chain Standa, was keen on doing business with Barrett. He pointed out that, over the past decade, there has been an explosion of interest among European supermarkets and food stores for exotic foods and vegetables, with each group competing to display produce from around the world. Standa was seeking new products from other countries, partly to meet off-season demand for fruit and vegetables. Gabrielle Donce, purchasing manager for French food group Fauchon, also confirmed her interest in showcasing exotic and high-quality food in Fauchon stores. She added that Europeans view Australia as a country that is exotic, pollution-free, and a producer of quality products. In addition, the market for canned fruit is opening up as the fruit crop from trees in Europe declines over time.

Mr. Austin also met Peter Telford, an agent from the United Kingdom who showed interest in representing Barrett Farm Foods in Europe. Mr. Telford talked about his knowledge of the market, extensive contacts, and prior business experience. He also noted that other Australian firms, such as Goodman Fielder Wattie, Burns Philip, Adelaide Steamship, Elders-IXL, SPC, and Southern Farmers, are already doing business in the region. He pointed to several success stories, including Sydney-based pastry manufacturer, C & M Antoniou, which has now established a small plant in Britain as a way of avoiding the considerable wall of agricultural duties surrounding the EU market. The company is now supplying several of Britain's major supermarket chains, including Marks & Spencer, Tesco, and Sainsbury's. Another Australian group, Buderim Ginger, has recently expanded its operations from Britain into continental Europe by opening an office in Germany.

Creating a Task Force

After the fair, Mr. Austin created a three-person task force among his senior managers and charged them with implementing an export drive. He felt that an export volume of US$30 million for the first year was reasonable. For products to be exported to Europe, Barrett would have to examine its current product offerings. It would appoint an agent, such as Peter Telford, to facilitate sales to European customers. The people Philip Austin met at the Cologne fair were potential customers to contact for immediate sales. The company could also forward some product and company literature to European importers, identify and appoint one or more distributors in Europe that have access to large-scale buyers such as supermarkets, and revamp its web site to attract export business.

While Barrett's senior managers shared Mr. Austin's enthusiasm about expanding to European markets, they did not share his optimism. Barrett had little internal expertise to deal with the complexities of international shipping, export documentation, and receiving payments from export customers. In addition, they knew that export transactions take a long time to complete, and the firm would have to arrange for financing of export sales. Most importantly, senior managers felt that they would have to invest in creating a small export team and quickly acquire or train employees who are proficient in export transactions.

Food is a complex business, in part because it is perishable, often requiring special equipment for distribution. In addition, Europe has many differences in national tastes, regulations, and market structures. Food products are especially susceptible to local preferences. For example, Vegemite—a dark brown, salty breakfast spread made from yeast—that is a favorite of the Australians, has little acceptance outside of Australia. Having no name recognition in the European Union, Barrett may also have to resort to store branding, which will generate lower profit margins.

Barrett will have to rely on competent foreign intermediaries with access to key supermarket chains to distribute its products. Is Peter Telford the right choice? What kind of commission will be necessary to compensate these intermediaries? With many larger, more experienced competitors in the European Union, Barrett must keep its pricing competitive, although the complexity of pricing can overwhelm inexperienced managers. Barrett's senior managers also realize that prices have a clear effect on sales and profits. The launch of Europe's common currency, the euro, simplified pricing strategy, but numerous challenges remain. Prices are affected by transportation costs, buyer demand, exchange rates, tariffs, competitors' pricing, regulatory compliance, and the costs of marketing and physical distribution.

AACSB: Reflective Thinking, Analytical Skills

Case Questions

1. Do you see any problems with Mr. Austin's plan for European expansion? Do you support his entrepreneurial approach to exporting? What should be the features of a more systematic approach to exporting?
2. Why did Barrett choose exporting as its entry strategy for Europe, as opposed to foreign direct investment or licensing? What advantages does exporting provide to Barrett? What are the potential drawbacks of exporting for Barrett?
3. What challenges can Barrett expect in its export drive? What types of new capabilities does the firm need to acquire to manage its export transactions?
4. How should Barrett choose between direct and indirect exporting? What are the ideal characteristics of European intermediaries for Barrett? If it chooses to minimize its risks, which of the three most commonly used Incoterms would Barrett favor? Where can Barrett turn for financing its export sales?

CHAPTER ESSENTIALS

Key Terms

barter, p. 407
buy-back agreement, p. 407
company-owned subsidiary, p. 393
compensation deals, p. 407
counterpurchase, p. 407
countertrade, p. 382
direct exporting, p. 392
documentation, p. 395
exporting, p. 382
global sourcing, p. 382
importing, p. 394
incoterms, p. 396
indirect exporting, p. 392
letter of credit, p. 398
Multilateral Development Bank (MDBs), p. 402

Summary

In this chapter, you learned about:

1. **An overview of foreign market entry strategies**

   Market entry strategies consist of *exporting*, *sourcing*, and *foreign direct investment*, as well as *licensing*, *franchising*, and *non-equity alliances.* Each strategy has advantages and disadvantages and places its own demands on corporate resources. To select a market entry strategy, managers must consider the firm's resources and capabilities, conditions in the target country, risks inherent in each venture, competition from existing and potential rivals, and the characteristics of the product or service to be offered in the market. **Importing** refers to the strategy of buying products and services from sources located abroad for use at home. It is also referred to as **global sourcing**, global purchasing, or global procurement.

2. **The internationalization of the firm**

   Firms internationalize due to *push factors* and *pull factors.* Initial internationalization may be accidental. Management must balance risk against return. Each international venture provides learning experiences that encourage further internationalization. Firms generally pass through stages of internationalization, going from relatively simple and low-risk entry strategies to more complex strategies.

3. **Exporting as a foreign market entry strategy**

   Exporting amounts to producing at home and then shipping products abroad, to be sold and delivered to foreign customers via intermediaries. It is the strategy favored by most firms when they first internationalize. Exporting is also a relatively flexible entry strategy, allowing the firm to readily withdraw in case of substantial problems in the target market. A systematic approach to exporting requires managers to perform a global market opportunity assessment, make organizational arrangements for exporting, acquire needed skills and competencies, as well as design and implement the export strategy. Among the organizational arrangements for exporting are **indirect exporting**, **direct exporting**, and establishing a **company-owned subsidiary**.

4. **Managing export-import transactions**

   Management must become familiar with customs clearance, international goods transportation, and **documentation**, the required forms and other paperwork used to conclude international sales. The exporter typically entrusts preparation of documents to a freight forwarder. In addition, national governments sometimes require exporters to obtain a license, a type of permission to export. **Incoterms** are universally accepted terms of sale that effectively specify what is and what is not included in the price of a product sold internationally, particularly with regard to the cost of transporting and insuring the good. Among the most commonly used Incoterms are EXW, FOB, and CIF.

5. **Methods of payment in exporting and importing**

   Exporting also requires knowledge of payment methods, such as cash in advance, **letter of credit**, open account, consignment sales, and countertrade. For most firms, letter of credit is best because it establishes immediate trust and protects both the buyer and seller.

6. **Cost and sources of export-import financing**

   Intense competition in export markets mandates that exporters offer attractive payment terms to their customers. Sources of finance for export transactions include commercial banks, *factoring*, *forfaiting*, and *confirming,* distribution channel intermediaries, intercompany financing, government assistance programs, and **multilateral development banks.**

7. **Identifying and working with foreign intermediaries**

   Managers can identify intermediaries, such as sales representatives and distributors, from a variety of public and private information sources. Qualified and committed foreign distributors are valuable *relational assets*. It is best to develop long-term relations with these business partners, who perform a variety of functions abroad on behalf of the exporter. Key to good relations include cultivating mutually beneficial bonds, genuinely responding to distributor needs, and encouraging loyalty. Success factors in exporting include being strongly committed to the export venture, doing market research, emphasizing strong products, developing an international business plan for each export venture, and adapting to foreign cultures.

8. Countertrade

Countertrade refers to an international business transaction where all or partial payments are made in kind rather than cash. Countertrade involves getting paid in goods or services, instead of currency. Also called two-way or reciprocal trade, countertrade operates on the principle of "I'll buy your products if you'll buy mine." There are four types of countertrade. **Barter** involves the direct exchange of goods without any money. **Compensation deals** involve payment both in goods and cash. **Counterpurchase** involves two distinct contracts. In the first contract, the seller agrees to sell its product at a set price and receives cash payment from the buyer. This first deal is contingent on a second contract wherein the seller also agrees to purchase goods from the buyer for the total monetary amount or a set percentage of same. **Buy-back agreements** involve the seller agreeing to supply technology or equipment to construct a facility and receives payment in the form of goods produced by the facility.

Test Your Comprehension AACSB: Reflective Thinking

1. What are the major foreign market entry strategies? What are the essential characteristics of each?
2. Describe the typical internationalization process that a firm may use in expanding abroad.
3. What is exporting? What are the major advantages and disadvantages of exporting?
4. Describe the organizing framework for exporting. What steps should the firm go through to ensure exporting success?
5. What are the major tasks involved in the management of export transactions?
6. Explain the primary payment methods that exporters typically use. What is the most reliable payment method, and how do exporters carry it out?
7. What are Incoterms, and why do firms follow them?
8. How would you go about identifying suitable foreign intermediaries?
9. What steps should the exporter take to ensure success in working with intermediaries?
10. Explain the nature, role, and risks involved in countertrade.

Apply Your Understanding AACSB: Communication, Reflective Thinking

1. Although most companies expand abroad gradually, some smaller firms internationalize at or near the firm's founding. The so-called born global firms represent a revolution in international business. Their emergence suggests that companies can participate actively in foreign markets from an early stage. Suppose you are an international business consultant and you have been contacted by management at a young firm that manufactures office furniture. The firm needs to generate more sales and wants to expand abroad. Given that internationalization is risky, particularly for smaller firms, what advice would you give them? In particular, what systematic approach to exporting and managing export-import transactions would you recommend?

2. Moose & Walrus is a manufacturer of a popular line of clothing for young people. Moose & Walrus is firmly established in its home market, which is relatively saturated and has little prospects for future sales growth. Moose & Walrus has decided to export its clothing line to Japan and various European countries. Because of the firm's strong manufacturing base in its home country, management has decided to internationalize through exporting, and has hired you to help with this effort. Prepare a briefing for senior managers and describe the advantages and disadvantages of exporting. In addition, recommend and describe payment methods.

3. Antenna Communications Technologies, Inc. (ACT) is a small satellite technology communications firm. Its product is a multibeam antenna that allows customers in the broadcast industry to receive signals from up to 35 satellites simultaneously. The firm has very limited experience in international business. ACT recently hired you as its export manager and, based on some extensive research, you have determined that substantial export markets exist for the product in Africa, China, Russia, and Saudi Arabia. You have followed most of the steps in the organizing framework for exporting and have decided that direct exporting is the most appropriate entry strategy for ACT. Your next task is to find distributors in the target markets. How would you go about this task? What resources should you access to find distributors in these markets? Once established, what is the best way to maintain solid relations with foreign distributors? Finally, what payment method should ACT use for most of its prospective markets?

globalEDGE Internet Exercises

(http://globalEDGE.msu.edu)

AACSB: Communication, Reflective Thinking

Refer to Chapter 1, page 27, for instructions on how to access and use globalEDGE™.

1. You work for a firm that manufactures children's toys. Your firm has little international experience and wishes to get started in exporting. Your boss understands the importance of using strong distributors abroad, but knows little about how to find them. Having studied international business in college, you know that many national governments offer programs that help new exporters find appropriate intermediaries in foreign countries. Examples of such programs include trade missions, trade shows, distributor search services, and matchmaker programs (in which the exporter is matched with foreign intermediaries). In the United States, for example, the International Trade Administration (ITA) provides various services for helping exporters find foreign distributors. Visit the web site of the ITA (www.ita.doc.gov), or the main trade support agency of your country (via globalEDGE™), and see what programs are available. Then prepare a memo to your boss in which you describe specific programs that you believe would help your firm get started in exporting.

2. Suppose you work for a major trading company involved in the exporting of timber in the lumber industry in Canada; of petroleum in the oil industry in Britain; and of processed food products in the agricultural industry in the United States. To enhance your career prospects, you want to become better informed about the export of these goods from their respective countries. Visit globalEDGE™ and research current international news about the above industries in the countries indicated. Based on your findings, prepare a brief report on the current status of each of the industries in their countries in the context of your firm's exporting efforts.

3. Suppose that your employer wants to export its products and get paid through letter of credit (LC). Suppose further that no one at the firm knows much about LCs. You have volunteered to become the company's LC expert. One way to accomplish this is to visit globalEDGE™ and do a search on the keywords "letter of credit." Another approach is to visit the web sites of major banks to learn about procedures and instructions for getting paid via LC. Exemplar banks include CIBC (www.cibc.com), the National Australia Bank www.national.com.au), and Wachovia (www.wachovia.com). As a preliminary step, visit the web sites of each of these banks and see what you can learn about LCs. For each bank, what are the requirements for getting an LC? What services does the bank offer in regard to LCs? Can you get training in LCs from these banks?

CKR Cavusgil Knight Riesenberger

Management Skill Builder©

Identifying An Attractive Export Market

Exporters seek the best foreign markets for their products and services. Managers conduct market research to determine the viability of potential export markets. They examine such factors as market size, growth rate, economic status, competition, and the degree of political stability. Without this market research, firms can fail in their export ventures.

AACSB: Reflective Thinking, Use of Information Technology

Managerial Challenge

The task of choosing the best export markets is complex. What makes an ideal market? What market potential indicators should managers consider? The managerial challenge is to choose the best export markets by following a systematic process of international market research.

Background

Exporting is the most widely used entry mode. This is especially true for firms that are new to international business and for firms with substantial production facilities at home. Research is particularly important to small and medium-sized enterprises, which usually lack the resources to sustain significant losses from failed exporting efforts.

Managerial Skills You Will Gain

In this C/K/R Management Skill Builder©, as a prospective manager, you will:

1. Learn the important indicators used to assess the viability of potential export markets
2. Access information needed to develop international business plans
3. Research country-level barriers that firms face in exporting

Your Task

Assume that you work for a firm that makes and markets portable DVD players. Management has decided to begin exporting the players abroad. Your task is to conduct market research aimed at formulating a ranking of the most viable countries that your firm should target with exports of portable DVD players. As part of the exercise, you will visit several online portals and gather relevant data.

Go to the C/K/R Knowledge Portal©

www.prenhall.com/cavusgil

Proceed to the C/K/R Knowledge Portal© to obtain the expanded background information, your task and methodology, suggested resources for this exercise, and the presentation template to use.