Chapter Fifteen

Exporting, Importing, and Countertrade
Opening Case

• FCX initially got into exporting because it found that foreigners were often more receptive to the company’s products

• Reasons for its export success
  - FCX has received assistance from a number of federal and state agencies
  - Persistence is also very important
  - They have made friends as well as gained customers
The Problems and Pitfalls of Exporting

- Firms that do not export lose out on huge opportunities for growth and cost reduction
- Large firms pro-active in seeking foreign opportunities
- Medium and small-sized firms slow to respond
  - Too busy with local side of business
  - Ignorance of potential opportunities
  - Intimidated by mechanics of exporting to a foreign country
Information sources

• U.S. Department of Commerce
  - International Trade Administration
  - United States and Foreign Commercial service agency
  - Provide “best prospects” list, “comparison shopping service,” and customized market research survey for a small fee
  - Organizes exhibitions at international trade fairs to help potential exporters make foreign contacts and explore export opportunities
  - Matchmaker program
Information sources

- Trade Commissions
  - Maintained by many large cities
  - Provide business counseling, information gathering, and financing
- Commercial banks and major accounting firms
Export Management Companies (EMC)

• Act as the export marketing department for clients
  - Help identify opportunities and avoid common pitfalls

• Two types of assignments
  - Begin exporting operating operations for firm with the understanding that the firm will take over operations once it is well established
  - Provide start-up services and have continuing responsibility for selling the firms products

• Drawback: A firm can fail to develop its own exporting capabilities
Export Strategy

- Risks can be decreased by taking few steps
- Hire an EMC or experienced export consultant to identify opportunities and deal with red tape
- Focus on a few markets to learn what is needed to succeed
- Enter on a small scale to reduce costs of any failure
- Invest time and managerial commitment in building export sales
Export Strategy

- Build strong and enduring relationships with local distributors and customers
- Hire local personnel
- Keep option of local production open
  - Cost-efficient economies of scale
  - Greater market acceptance
Export and Import Financing

- Lack of trust between international trading partners due to several factors
  - Parties have never met
  - Language, cultural, and legal system differences
  - Difficulties in tracking down a party in case of default
- Problem solved by using a third party trusted by both as an intermediary – normally a reputable bank
Tools Used to Aid Transactions

- **Letters of Credit (LOC)**
  - Bank guarantee on behalf of importer to exporter assuring payment when exporter presents specified documents

- **Drafts (Bill of Exchange)**
  - Written order by exporter, telling an importer to pay a specified amount of money at a specified time

- **Bill of Lading**
  - Issued to exporter, by carrier
  - Serves as receipt, contract, and document of title
Letter of Credit

- Issued by a bank at the request of the importer
- Bank pays a specified sum to a beneficiary, normally the exporter, on presentation of particular, specified documents
- Fee paid by importer for letter of credit
- May reduce borrowing ability of importer since the letter is a financial liability
Draft (Bill of Exchange)

- Written by an exporter instructing an importer to pay specified amount of money at specified time
- Required before the buyer can obtain the merchandise
- Two types
  - Sight drafts - payable on presentation to the drawee
  - Time draft - negotiable instrument allowing for delay in payment
Bill of Lading

- Issued to the exporter by the common carrier transporting the merchandise
- Serves three purposes:
  - **Receipt** - merchandise described on document has been received by carrier
  - **Contract** - carrier is obligated to provide transportation service in return for a certain charge
  - **Document of title** – can be used to obtain payment or a written promise before the merchandise is released to the importer
Export and Import Financing

Preference of a US exporting Firm

Preference of a French importing Firm

1. Importer Pays for the Goods
   - French Importer
   - American Exporter

2. Exporter Ships the Goods After Being Paid

1. Exporter Ships the Goods
   - French Importer
   - American Exporter

2. Importer Pays After the Goods Are Received
Using a Third Party

1. Importer Obtains Bank's Promise to Pay on Importer's Behalf
2. Bank Promises Exporter to Pay on Behalf of Importer
3. Exporter Ships “to the Bank,” Trusting Bank’s Promise to Pay
4. Bank Pays Exporter
5. Bank Gives Merchandise to Importer
6. Importer Pays Bank
Typical International Transaction

1. Importer Orders Goods
2. Exporter Agrees to Fill Order
3. Importer Arranges for Letter of Credit
5. Bank of New York Informs Exporter of Letter of Credit
6. Goods Shipped to France
7. Exporter Presents Draft to Bank
9. Bank of Paris Returns Accepted Draft
10. and 11. Exporter Sells Draft to Bank
12. Bank Tells Importer Documents Arrive
13. Importer Pays Bank

McGraw-Hill/Irwin
International Business, 6/e
Export Assistance

- Two forms of government-backed assistance prospective U.S. exporters can draw on for financing
  - Export-Import Bank
  - Export Credit Insurance

www.Exim.gov
Export-Import Bank

- Referred to as Eximbank
- Provides loans and loan-guarantee programs
- Makes commercial banks more willing to lend cash to foreign enterprises
- Lends money to foreign borrowers to purchase U.S. exports
Export Credit Insurance

- Provided by Foreign Credit Insurance Association (FCIA)
- Consists of private commercial institutions operating under the guidance of Export-Import Bank
- Provides credit insurance in case importer defaults in payment
- Commercial and political risks taken into account
The Role of Government in the Export/Import Environment

- **Political**
  - Protecting jobs and industries
  - National security
  - Retaliation

- **Economic**
  - Develop/protect infant industry
  - Strategic trade policy
    - First mover advantage
    - The ‘catch-up’ argument
Countertrade

Countertrade is an alternative means of structuring an international sale when conventional means of payment are difficult, costly, or nonexistent.

- Governments may restrict the convertibility of their currency.
Countertrade

- Denotes a whole range of barter-like agreements
- Primarily used when a firm exports to a country whose currency is not freely convertible
  - Developing countries e.g. former USSR
- Importing country may lack the foreign exchange reserves required
- 8 to 10% of world trade in form of countertrade
  - Example: Venezuelan government’s contract with Caterpillar
Types of Countertrade

• Barter
  - Direct exchange of goods and services between two parties without a cash transaction
  - Two-fold problems
    • If goods are not exchanged simultaneously, one party ends up financing the other for a period
    • Goods may be unwanted, unusable, or have a low re-sale value

• Counterpurchase
  - Reciprocal buying agreement
Types of Countertrade

- **Offset**
  - One party agrees to purchase goods and services with a specified percentage of the proceeds from the original sale
  - Party can fulfill the obligation with any firm in the country to which the sale is being made
  - Gives exporter greater flexibility to choose goods to be purchased

- **Switch trading**
  - Occurs when a third-party trading house buys the firm’s counterpurchase credits and sells them to another firm that can better use them
Types of Countertrade

- Compensation or buybacks
  - Occurs when a firm builds a plant in a country or supplies technology, equipment, training, or other services
  - Agrees to take certain percentage of plant’s output as partial payment for the contract
Advantages of Countertrade

- Means to finance an export deal when other means are not available
- Unwilling firms may lose an export opportunity and be at a competitive disadvantage
- Countertrade can become a strategic marketing weapon
Disadvantages of Countertrade

- Accept alternative means of payment instead of hard currency
- Exchange of unusable or poor-quality goods that cannot be disposed profitably
- Expenses relating to maintaining an in-house trading department to arrange and manage countertrade deals
Firm Suitability to Countertrade

- Countertrade most attractive to huge multinationals that can use their worldwide network of contacts to most profitably dispose goods
Looking Ahead to Chapter 16

• Global production, Outsourcing, and Logistics
  - Strategy, Production, and Logistics
  - Where to Produce
  - The Strategic Role of Foreign Factories
  - Outsourcing Production: Make-or-Buy Decisions
  - Managing a Global Supply Chain