



Foreign Trade Operations

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Introduction

- This chapter is concerned with the “nuts and bolts” of foreign trade operations. Exporting is not just for large enterprises, many small firms have benefited significantly from the moneymaking opportunities of exporting too.
- The volume of export activity in the world economy is increasing as exporting has become easier
- Despite the opportunities for exporting, it remains a challenge for many firms :
 - ❖ What are the opportunities and risks associated with exporting? **Political risks, cultural risks, foreign exchange risks.**
 - ❖ How can companies improve their export performance?
 - ❖ What information programs and government resources can help exporters?
 - ❖ What are the basic steps in financing exporting?
 - ❖ How can countertrade facilitate exporting?



The reasons of expansion

The factors that drive enterprises to seek business development and growth through international and global operations:

- ❖ **Market factors**
- ❖ **Cost factors**
- ❖ **Competitive factors**
- ❖ **The international business environment**



Basic foreign expansion entry decisions

- A firm preparing foreign expansion must make three decisions
 - ❖ Which markets to enter
 - ❖ When to enter these markets - Timing of entry
 - ❖ What is the scale of entry (Large scale entry, Small scale entry)



Entry modes

- ❖ **Exporting**
- ❖ **Turnkey Projects**
- ❖ **Licensing**
- ❖ **Franchising**
- ❖ **Joint Ventures**
- ❖ **Wholly Owned Subsidiaries**



Export Strategy

- it often makes sense to initially focus on one, or few of markets.
- it may make sense to enter a foreign market on a fairly small scale in order to reduce the costs of any subsequent failure.
- the exporter needs to recognize the time and managerial commitment involved in building export sales,
- in many countries it is important to devote a lot of attention to building strong and enduring relationships with local distributors and / or customers.
- it is important to hire local personnel to help the firm establish itself in a foreign market.



Exporting Promises

- **Large firms may realize promise**
 - are proactive about exporting
 - systematic with exporting effort
 - have knowledge of foreign markets
 - can see where they can leverage their technology, products and marketing skills
- **Medium and small-sized firms slow to respond**
 - Too busy with local side of business
 - Ignorance of potential opportunities
 - Scared of mechanics of exporting to a foreign country



Exporting Pitfalls

- Poor market analysis
- Superficial understanding of competitive conditions
- Underestimation of time and expertise needed to develop a foreign export market
 - Some customers require face-to-face interactions
 - Lack of allocation of sufficient managerial resources
 - Underestimation of need/value to develop local relationships (“let the agent deal with this”)
- Failure to customize the product to the needs of foreign users (industrial or consumer)
- Ineffective distribution system
- Weak promotion program
- Poor understanding of involved logistics



Exporting

- **Advantages:**
 - Avoids cost of establishing manufacturing operations
 - Helps improve economy
 - Country can buy other necessary item by the money earned from export
- **Disadvantages:**
 - May compete with low-cost location manufacturers
 - Possible high transportation costs
 - Tariff barriers
 - Possible lack of control over marketing



Export Assistance in the Czech Republic

- Prospective Czech exporters can draw on three forms of government-backed assistance to help their export programs. They can get financing aid from the **Czech Export Bank, a.s** and insurance from **Export Guarantee and Insurance Corporation "EGAP"** and help from **Czech Trade Promotion Agency – Czech Trade**.
- **Czech Export Bank, a.s**
 - Independent bank of Czech Government
 - Provides financing for Czech exports, imports, and exchange of commodities
- **Export Guarantee and Insurance Corporation "EGAP"**
 - A state-owned export credit agency, insuring credits connected with exports of goods and services from the Czech Republic against political and commercial risks. EGAP, now part of the state export support programme, provides insurance services to all exporters of Czech goods irrespective of their size, legal form and volume of insured exports - Exportní garanční a pojišťovací společnost, a.s.
- **Czech Trade Promotion Agency - Czech Trade**
 - Supplier search and Promotion of Czech goods and services
 - organize business visits



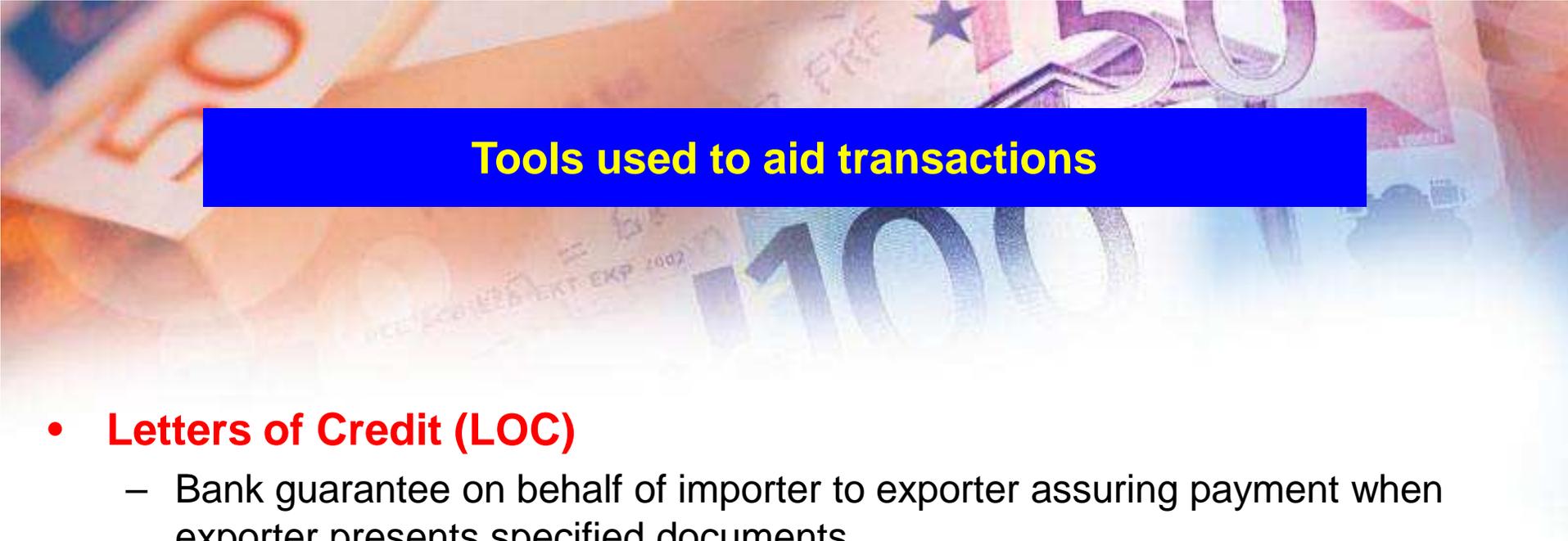
Export Guarantee and Insurance Corporation "EGAP"

- Provides credit insurance in case importer defaults in payment
- Provides loans and loan-guarantee programs
- Makes commercial banks more willing to lend cash to foreign enterprises
- Lends money to foreign borrowers to purchase Czech exports



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
- Exporter to be assured of payment and importer to be assured of product



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 issued by the 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



Counter Trade

- **Countertrade is an alternative means of structuring an international sale when conventional means of payment are difficult, costly, or nonexistent.**
- **A range of barter like agreements**
 - Trade goods/services for other goods/services
 - Used when currencies not convertible
 - Used when the currencies are too unstable
- **The Growth of Countertrade**
 - In the modern era, countertrade arose in the 1960s as a way for the Soviet Union and the Communist states of Eastern Europe, whose currencies were generally nonconvertible, to purchase imports.
 - During the 1980s, the technique grew in popularity among many developing nations that lacked the foreign exchange reserves required to purchase necessary imports. There was a notable increase in the volume of countertrade after the Asian financial crisis of 1997.



Types of Countertrade

- **Barter** is a direct exchange of goods and/or services between two parties without a cash transaction. Barter is viewed as the most restrictive countertrade arrangement. It is used primarily for one-time-only deals in transactions with trading partners who are not creditworthy or trustworthy. Barter: direct exchange of goods.
- **Counterpurchase** is a reciprocal buying agreement. It occurs when a firm agrees to purchase a certain amount of materials back from a country to which a sale is made. Each transaction is separately fulfilled and paid in cash.
- **Buy back** occurs when a firm builds a plant in a country—or supplies technology, equipment, training, or other services to the country—and agrees to take a certain percentage of the plant's output as a partial payment for the contract.



Types of Countertrade

- **Total Compensation** occurs when exported goods are paid fully by a countersupply of goods.
- **Partial Compensation** occurs when exported goods are paid for partly by a countersupply of goods.
- **Switch trading** refers to the use of a specialized third-party trading house in a countertrade arrangement. When a firm enters a counterpurchase or offset agreement with a country, it often ends up with what are called counterpurchase credits, which can be used to purchase goods from that country. 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.
- **Offset** is similar to counterpurchase insofar as one party agrees to purchase goods and services with a specified percentage of the proceeds from the original sale. The difference is that this party can fulfill the obligation with any firm in the country to which the sale is being made. **Direct offset** – buying related products. **Indirect offset** – buying unrelated products.



Types of countertrade

• Barter

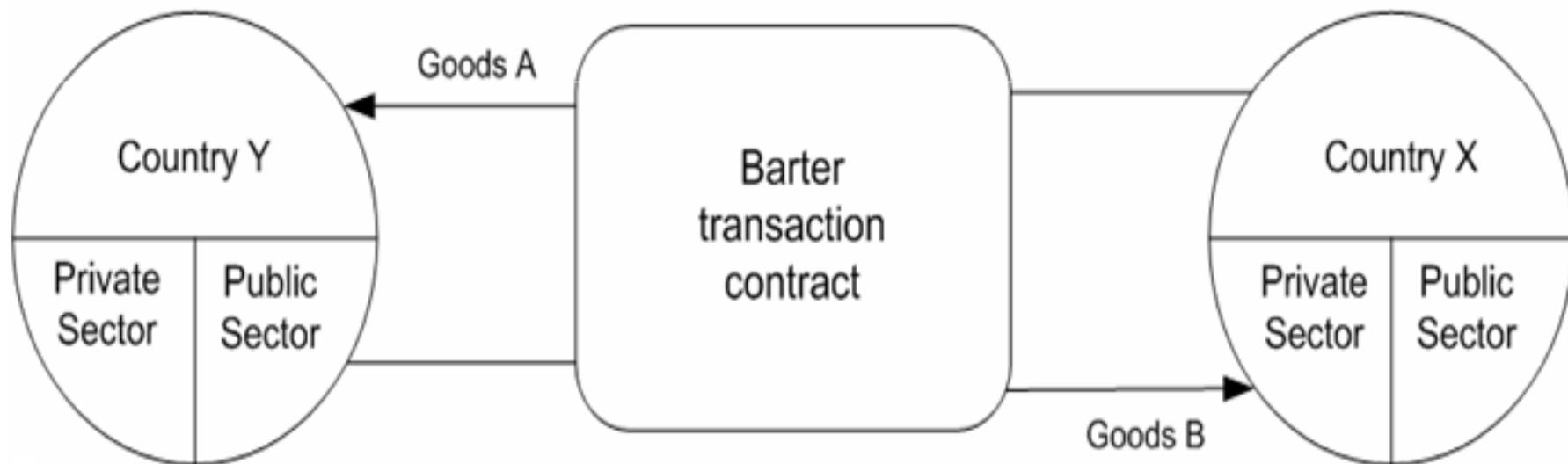
- Direct exchange of goods and services between two parties without a cash transaction
- Two fold problems
 - If goods are not exchanged simultaneously, one party ends up financing the other for a period
 - Goods may be unwanted, unusable or have a low re-sale value

• Counterpurchase

- Reciprocal buying agreement
- Each transaction is separately fulfilled and paid in cash.

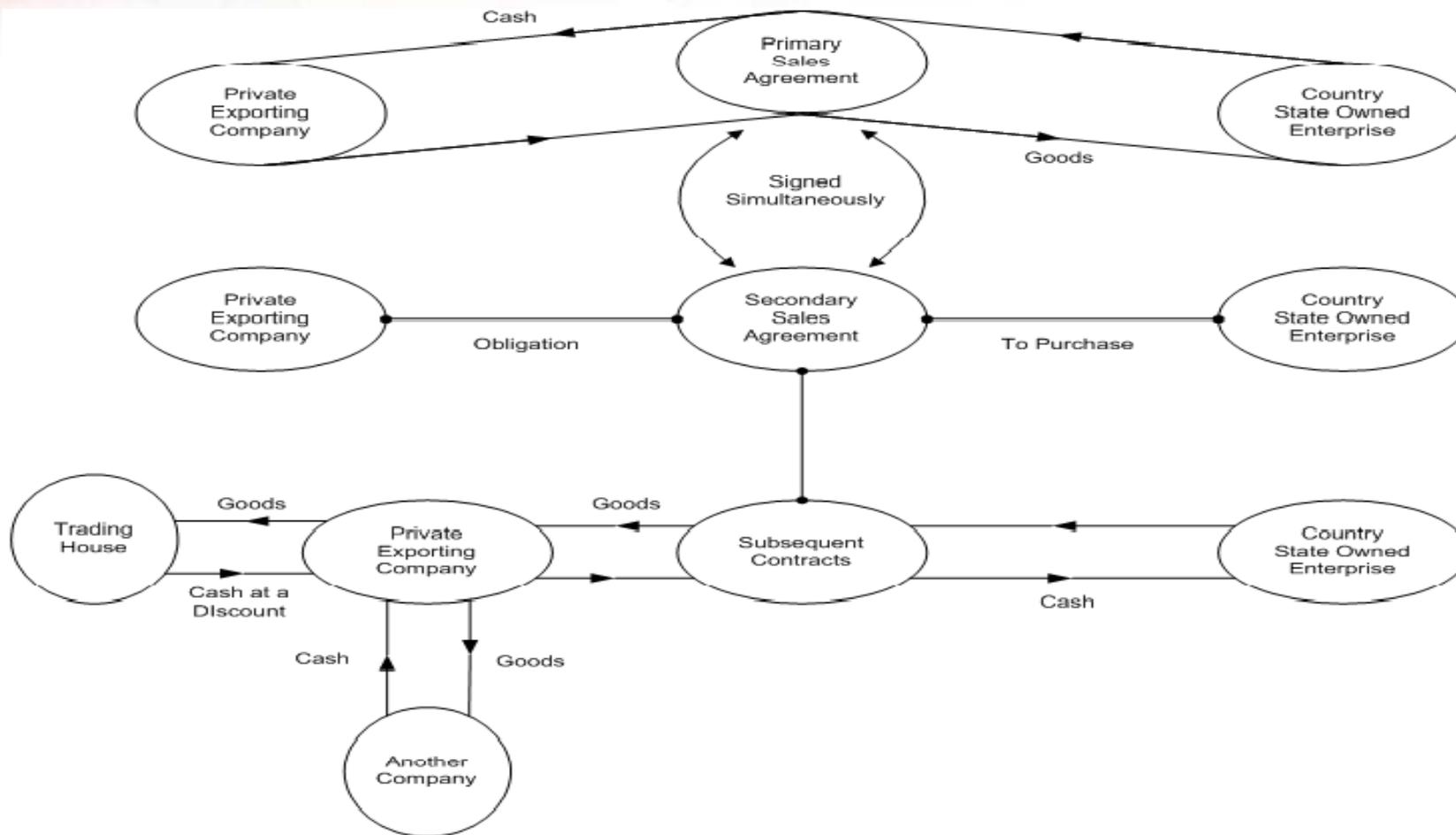
Barter

Barter



Trade carried out wholly or partially in goods rather than money

Counterpurchase



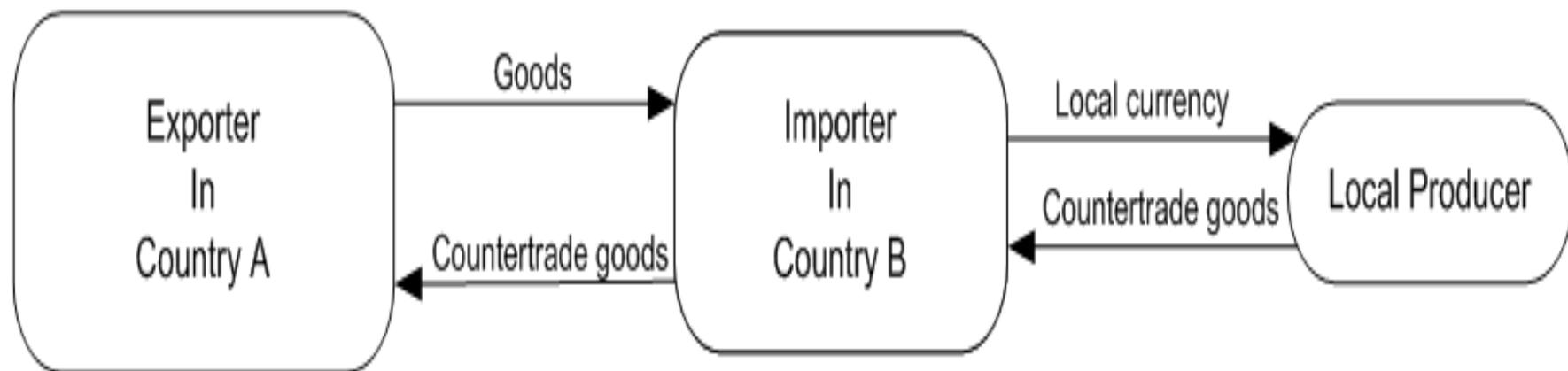
Partial Compensation

Partial Compensation



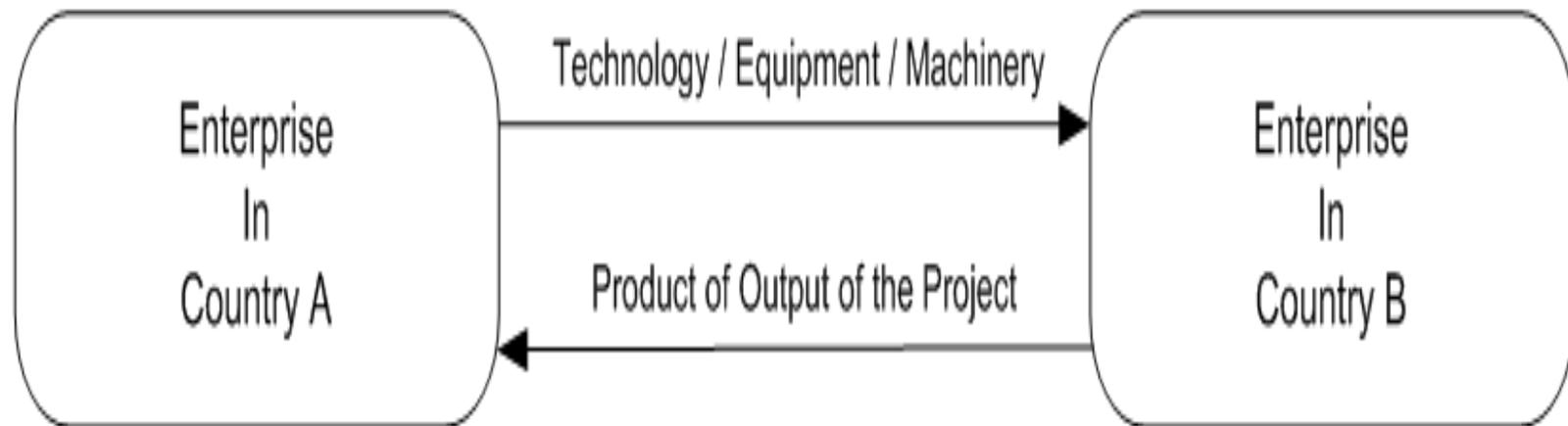
Total Compensation

Total Compensation



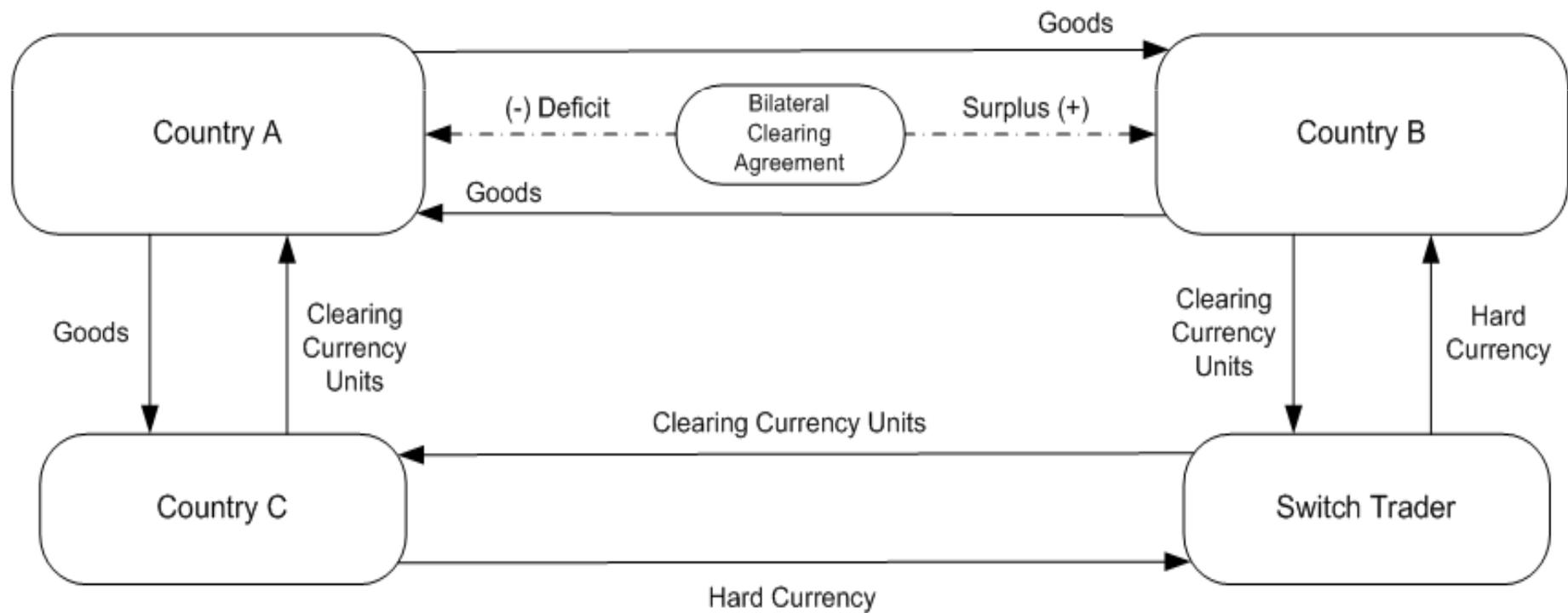
Buy - Back

Buy - Back



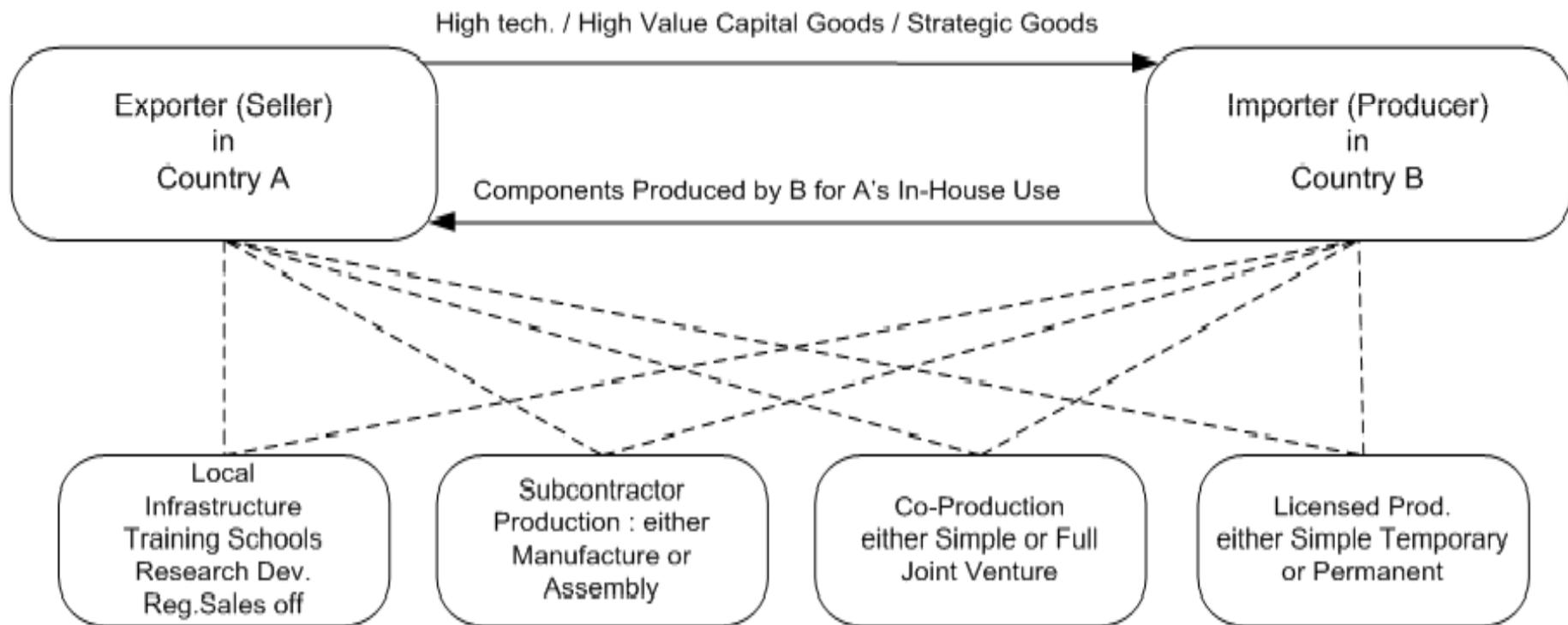
Switch Trading

Switch Trading



Direct Offset

Direct Offset





Types of Countertrade

- **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



Counter trade

- **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



Advantages and Disadvantages 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
- Accept alternative means of payment instead of hard currency
- Can be the preferred financing method in cases where cash deals are too risky
- Exchange of unusable or poor-quality goods that cannot be disposed profitably



Turnkey projects

- **Advantages:**

- Can earn a return on knowledge asset
- Less risky than conventional FDI

- **Disadvantages:**

- No long-term interest in the foreign country
- May create a competitor
- Selling process technology may be selling competitive advantage as well



Licensing: Advantages

- Reduces development costs and risks of establishing foreign enterprise.
- Lack capital for venture.
- Unfamiliar or politically volatile market.
- Overcomes restrictive - investment barriers.

Agreement where licensor grants rights to intangible property to another entity for a specified period of time in return for royalties.



Franchising

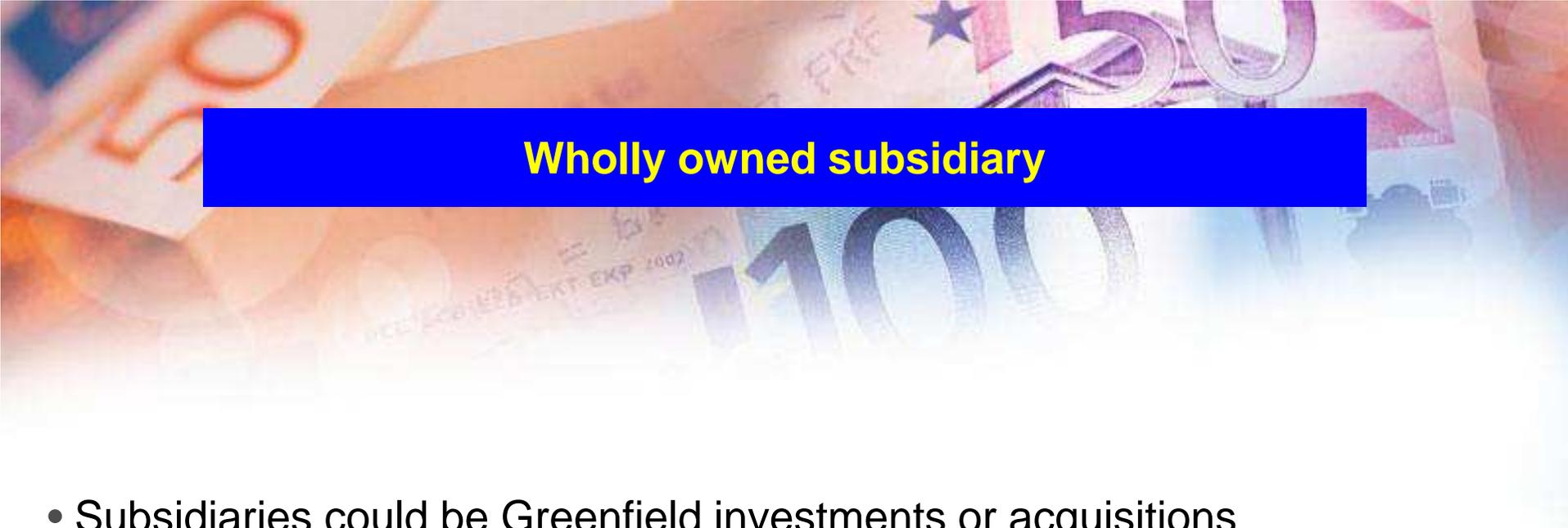
- **Advantages:**
 - Reduces costs and risk of establishing enterprise
- **Disadvantages:**
 - May prohibit movement of profits from one country to support operations in another country
 - Quality control

Franchiser sells
intangible property
and insists on rules
for operating business



Joint Ventures

- **Advantages:**
 - Benefit from local partner's knowledge.
 - Shared costs/risks with partner.
 - Reduced political risk.
- **Disadvantages:**
 - Risk giving control of technology to partner.
 - Shared ownership can lead to conflict



Wholly owned subsidiary

- Subsidiaries could be Greenfield investments or acquisitions
- **Advantages:**
 - No risk of losing technical competence to a competitor
 - Tight control of operations.
- **Disadvantage:**
 - Bear full cost and risk

Acquisition and Green-field- pros & cons

Acquisition

- **Pro:**
 - Quick to execute
 - Preempt competitors
 - Possibly less risky
- **Con:**
 - Disappointing results
 - Culture clash.
 - Problems with proposed synergies

Greenfield

- **Pro:**
 - Can build subsidiary it wants
 - Easy to establish operating routines
- **Con:**
 - Slow to establish
 - Risky
 - Preemption by aggressive competitors

Advantages and disadvantages of entry modes

Entry Mode	Advantages	Disadvantages
Exporting	Ability to realize location and experience curve economies	High transport costs Trade barriers Problems with local marketing agents
Turnkey contracts	Ability to earn returns from process technology skills in countries where FDI is restricted	Creating efficient competitors Lack of long-term market presence
Licensing	Low development costs and risks	Lack of control over technology Inability to realize location and experience curve economies Inability to engage in global strategic coordination
Franchising	Low development costs and risks	Lack of control over quality Inability to engage in global strategic coordination
Joint ventures	Access to local partner's knowledge Sharing development costs and risks Politically acceptable	Lack of control over technology Inability to engage in global strategic coordination Inability to realize location and experience economies
Wholly owned subsidiaries	Protection of technology Ability to engage in global strategic coordination Ability to realize location and experience economies	High costs and risks



Thank You for your Attention



Literature

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