

Assessing International Markets



Think locally, offer value, and be patient. That last one is key: You can make an elephant dance. But it takes time to learn the right tune.

—Om Malik on Marketing to India, *Business 2.0*

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International Marketing Consultant In Focus: Faith Popcorn

Faith Popcorn, an international marketing consultant and president of the BrainReserve firm, seems more like a futurist, entertainer, or guru than a marketing consultant. Just her last name itself (she was born a Plotkin) suggests a playful cleverness and desire to be noticed and remembered. A former advertising agency creative director, she provides international businesses with predictions of future trends and then connects these trends to consumer behavior.

Some of her past predictions have been pretty accurate. She identified the consumer trends of cocooning, food coaches, and transcuture (using couture designs as a source of material, a bit like musical mixing and sampling)—all of which have come to pass. She also accurately predicted the growth of the entertainment industry in the recession. In her TrendBank, she includes the development of these trends over the next few years (adapting her descriptions):

- *99 lives*: living many different lives at the same time—the rush and role-multiplicity of the modern world, online, as a parent, as a student, as an organization member, and so on.
- *Anchoring*: reaching back to our spiritual roots; taking what was secure from the past to be ready for the future.
- *Atmosfear*: consumer fear and uncertainty stirred up by concerns about contaminated water, tainted food, and unclean air.
- *Being alive*: awareness that good health extends longevity and leads to a new way of life.
- *Cashing out*: working men and women question career satisfaction and goals and opt for a simpler life.
- *Eveolution*: the ways women think and behave are moving business from a hierarchical to a relational model.
- *EnGen*: the end of gender differences.

A *Los Angeles Times* reporter tracked Popcorn's predictions over a five-year period, and his conclusions were that she was bang-on in her predictions far and, hence, worth listening to.^a Other trackers mark her predictions at a 95 percent accuracy rate. In fact, major corporations check out their marketing moves with her before they implement. Her site, www.faithpopcorn.com, is worth a visit because it lists her current trend predictions.

^aPatrick Kevin Day, *Los Angeles Times*, September 30, 2008, <http://latimes.com> (accessed June 14, 2011).

learning objectives

After reading this chapter, you should be able to:

- LO12-1** **Discuss** environmental analysis and two types of market screening.
- LO12-2** **Explain** market indicators and market factors.
- LO12-3** **Describe** some statistical techniques for estimating market demand and grouping similar markets.
- LO12-4** **Discuss** the value to businesspeople of trade missions and trade fairs.
- LO12-5** **Discuss** some of the problems market researchers encounter in foreign markets.
- LO12-6** **Discuss** the different options for conducting survey-based research.
- LO12-7** **Explain** the difference between country screening and segment screening.

market screening

A version of environmental scanning in which the firm identifies desirable markets by using the environmental forces to eliminate the less desirable markets

environmental scanning

A procedure in which a firm scans the world for changes in the environmental forces that might affect it

As described in Section Two of this book, international environmental forces can complicate management efforts to assess the attractiveness of expanding into foreign markets. Companies have used a broad range of approaches to assess international markets, some of them rather unsystematic and prone to error. We think that many international managers might prefer to use a more systematic approach, and in the following pages, we describe in some detail a structured approach to the international market screening process.

The first step in the market screening process is determining the basic need potential. We describe this process in the next section. **Market screening** is a modified version of environmental scanning in which the firm identifies markets by using the environmental forces to eliminate the less desirable markets.

Environmental scanning, from which market screening is derived, is a procedure in which a firm scans the world for changes in the environmental forces that might affect it.¹ For some time, environmental scanning has been used by managers during the planning process to provide information about world threats and opportunities. Those who do environmental scanning professionally may belong to such organizations as the Society of Competitive Intelligence Professionals (www.scip.org). In addition, environmental scanning services are available from a number of private firms. Examples of such service providers include Smith Brandon International (www.smithbrandon.com) and Stratfor (www.stratfor.com).

Market Screening

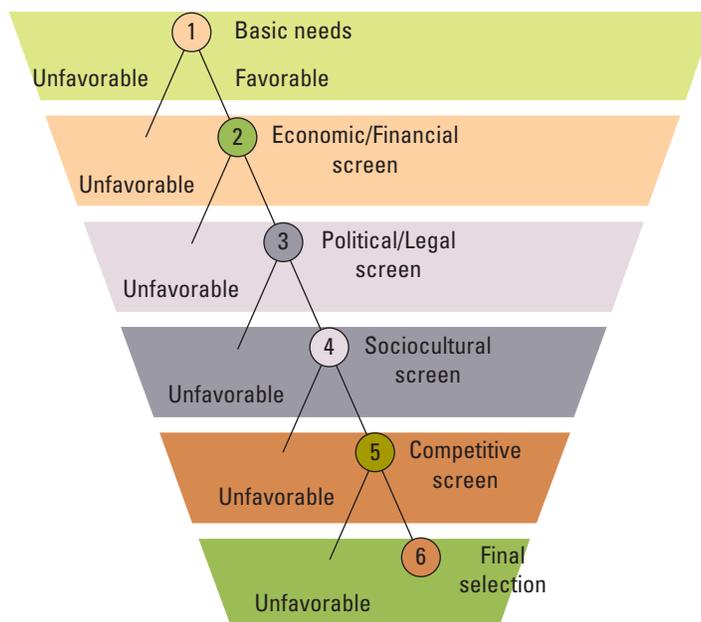
Market screening is a method of market analysis and assessment that permits management to identify a small number of desirable markets by eliminating those judged to be less attractive. This is accomplished by subjecting the markets to a series of screenings based on the environmental forces examined in Section Two. Although these forces may be placed in any order, the arrangement suggested in Figure 12.1 is designed to progress from the least to the most difficult analysis based on the accessibility and subjectivity of the data. In this way, the smallest number of candidates is left for the final, most difficult screening.

Market screening assists two different kinds of firms. One is selling exclusively in the domestic market but believes it might increase sales by expanding into overseas markets. The other is already a multinational but wants to avoid missing potential new markets. In both situations, managers require an ordered, relatively fast method of analyzing and assessing the nearly 200 countries (and multiple market segments within countries) to pinpoint the most suitable prospects.

L012-1 Discuss
environmental analysis and two types of market screening.

FIGURE 12.1

Selection of Foreign Markets



Two Types of Market Screening— Country and Segment

In this chapter, we will look at two types of market screening procedures. The first, **country screening**, uses countries as the relevant unit of analysis. The second, **segment screening**, is based on a subnational analysis of groups of consumers.

country screening
Using countries as the basis for market selection

Country Screening

INITIAL SCREENING—BASIC NEEDS POTENTIAL

Basic Need Potential An initial screening based on the basic need potential is a logical first step, because if the need is lacking, no reasonable expenditure of effort and money will enable the firm to successfully market its goods or services. For example, the basic need potential of certain goods is dependent on various physical forces, such as climate, topography, and natural resources. If the firm produces air conditioners, the analyst will look for countries with warm climates. Manufacturers of large farm tractors might not consider Switzerland a likely prospect because of its mountainous terrain. Manufacturers of large yachts might consider a landlocked country such as Paraguay to be an unattractive potential market, and only areas known to possess gold deposits are probable markets for gold-dredging equipment.

Generally, producers of specialized industrial materials or equipment experience little difficulty in assessing their basic need potential. A list of firms in an industry, often on a worldwide basis, is available either from the specific industry association for that industrial sector or from specialized trade journals. A builder of cement kilns, for example, can obtain the names and addresses of cement plants worldwide through the website of the Portland Cement Association. What about less specialized products that are widely consumed? For example, it is problematic to establish a basic need for chocolate and harder still to do so for MP3 players, consumer robots, or movies on Blu-ray discs. In these cases, we are moving from needs to wants.

segment screening
Using market segments as the basis for market selection



Foreign Trade Analysts who want to know where American competitors are exporting their products can go to the Web site of the International Trade Administration (ITA), www.ita.doc.gov. The U.S. Department of Commerce also has the report *U.S. Exports of Merchandise* on the National Trade Data Bank (NTDB), which is available online for a subscription fee. This report's information is especially useful because it includes both units and dollar values, permitting the analyst to calculate the average price of the unit exported. The Department of Commerce compiles and releases foreign trade statistics on a monthly and cumulative basis in its report *U.S. International Trade in Goods and Services*, commonly referred to as the FT900. It is published as a press release and can be found at www.census.gov/foreign-trade/Press-Release/current_press_release/index.html.

For help in their search for markets, analysts can obtain from the nearest Department of Commerce office numerous studies prepared by U.S. embassies. *Annual Worldwide Industry Reviews* and *International Market Research Reports* indicate major markets for many products.

The *Country Market Surveys* indicate products for which there is a good, established market in a given country. Other countries publish similar data. For example, the data office of the European Union (Eurostat) publishes an annual, *External Trade*, and JETRO (the Japanese External Trade Organization), publishes a wide assortment of trade and industry data, many of which are put on its Internet site.

Imports Do Not Completely Measure Market Potential Even when a basic need is clearly indicated, experienced researchers will still investigate trade flows in order to have an idea of the magnitude of present sales. Of course, imports alone seldom measure the full market potential. Myriad reasons are responsible, among which are poor marketing, lack of foreign exchange, and high prices (potentially caused by transportation, duties and markups). Neither can imports give much indication of the potential demand for a really new product.

Moreover, import data indicate only that a market has been buying certain products from abroad and are no guarantee that these imports will continue. A competitor may decide to produce locally, which, in many markets, will cause imports to cease. Change in a country's political structure also may reduce or eliminate imports, as we saw in the case of Iran after the revolution there, when orders worth billions of dollars were suddenly canceled. Nevertheless, import data do provide the firm with an indication of how much product is currently being purchased and provide managers with a conservative estimate of the immediate market potential at the going price. If local production is being considered and calculations show that goods produced in the country could be sold at a lower price, the firm might reasonably expect to sell more than the quantity currently being imported.

SECOND SCREENING—FINANCIAL AND ECONOMIC FORCES

After the initial screening, the analyst will have a much smaller list of prospects. This list may be further reduced by a second screening based on the financial and economic forces. Trends in inflation, currency exchange rates, and interest rates are among the major financial points of concern. The analyst should consider other financial factors, such as credit availability, paying habits of customers, and rates of return on similar investments. It should be noted that this screening is not a complete financial analysis. That will come later if the market analysis and assessment disclose that a country has sufficient potential for capital investment.

Economic data may be employed in a number of ways, but two measures of market demand based on them are especially useful. These are *market indicators* and *market factors*. Other methods for estimating demand that depend on economic data are *trend analysis* and *cluster analysis*.

TABLE 12.1 E-Commerce Potential: Rankings for Latin America

Countries	Market Size	Market Growth Rate	E-Commerce Readiness	Overall E-Commerce Potential
South America				
Argentina	4	17	3	6
Bolivia	17	5	15	15
Brazil	5	12	3	4
Chile	1	5	1	1
Colombia	11	7	9	9
Ecuador	14	1	9	6
Paraguay	12	16	15	17
Peru	12	3	15	11
Uruguay	7	20	9	12
Venezuela	2	19	7	9
Caribbean				
Dominican Republic	10	9	9	9
Haiti	20	18	20	19
Jamaica	3	14	2	3
Central America				
Costa Rica	6	2	3	2
El Salvador	15	13	9	12
Guatemala	17	11	9	12
Honduras	15	4	19	15
Mexico	6	15	3	6
Nicaragua	17	10	15	17
Panama	5	6	7	4

Source: Michael S. Minor and Alexandra Brandt, "A Possible Index of E-Commerce Potential for Latin America," working paper, January 8, 2002, updated June 2006 by Adesegun Oyedele and October 2008 by Michael S. Minor. Reprinted with permission of the authors.

Market Indicators Market indicators are economic data that serve as yardsticks for measuring the relative market strengths of various geographic areas. As an example, we developed an index of e-commerce potential for Latin America so that the countries in the region could be compared. The results appear in Table 12.1. In this methodology, we assembled data on 20 Latin American countries and then ranked the countries against each other. We wanted to include indicators of the strength and growth rate of the overall economy, as well as factors related more specifically to e-commerce or to communications that would aid the growth of e-commerce. We developed three indices. Each indicator is given equal weight in each index.

Market size = Size of urban population + Electricity consumption

Market growth rate = Average growth rate in commercial energy use + Real growth rate in GDP

E-commerce readiness = Mobile phones per 1,000 + Number of PCs per 1,000 + Internet hosts per million people

The rankings on these three indexes were then used to form a composite ranking. We called this composite ranking the "e-commerce potential." As you can see in Table 12.1, by using our methodology, the countries with the most e-commerce potential appear to be Chile, Costa Rica, Jamaica, and Brazil, while Paraguay, Nicaragua, and Haiti appear to have the least potential.

L012-2 Explain market indicators and market factors.

market indicators Economic data used to measure relative market strengths of countries or geographic areas

market factors

Economic data that correlate highly with market demand for a product

estimation by analogy

Process of using a market factor that is successful in one market to estimate demand in a similar market

trend analysis

Statistical technique by which successive observations of a variable at regular time intervals are analyzed to establish regular patterns that are used for establishing future values

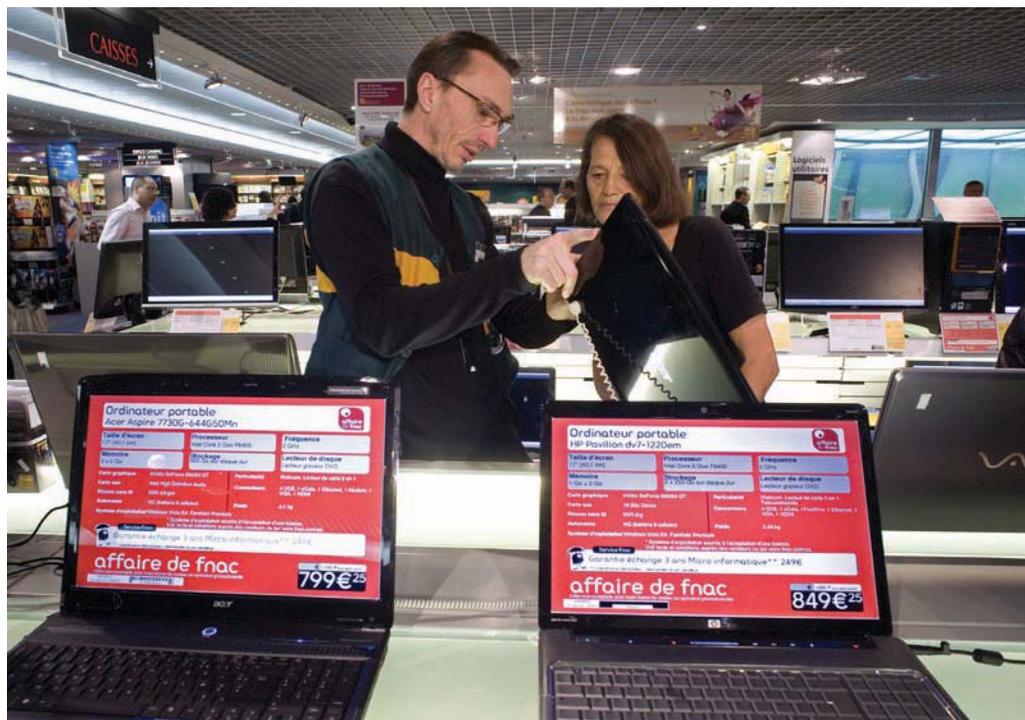
Market Factors

Market factors are similar to market indicators except that they tend to correlate highly with the market demand for a given product. If analysts of a foreign market have no factor for that market, they may be able to use one from the domestic market to provide an approximation for the foreign market. Moreover, analysts who work for a multinational firm may be able to obtain market factors developed by comparable subsidiaries. To be able to transfer these relationships to the country under study, the analysts must assume that the underlying conditions affecting demand are similar in the two markets.

We can illustrate this process, which is called **estimation by analogy**, by using the following example. If a supplier of laptops knows that one-fifth of all laptops are replaced every year in the United Kingdom, he or she might use the same relationship to estimate demand for replacement computers in a new overseas market. If there are 3 million existing laptops in the new market, the analyst might forecast that $3 \text{ million} \times 0.20$, or 600,000, replacement laptops will be sold annually. The constant in the country under study may be somewhat different (it usually is), but with this approach, the estimates will represent a reasonable approximation and a base from which further analysis can be conducted. Many such factors exist, and generally research personnel, either at the home office or in foreign subsidiaries, are familiar with them.

Trend Analysis

When the historical growth rates of either the pertinent economic variables or the imports of a product are known, future growth can be forecast by means of **trend analysis**. A time series may be constructed in a manner similar to the way a regression model is made, or the arithmetic mean of past growth rates may be applied to historical data. Caution is advised when using the second method because if the average annual growth rate is applied mechanically, in just a few years the dependent variable may reach an incredible size. For example, a 5 percent growth rate, compounded annually, will result in a doubling of the original value in only 15 years. Because trend analysis is based on, the assumption that past conditions affecting the dependent variable will remain constant, analysts will generally modify the outcome to take into account any changes that can be foreseen or to create alternate scenarios for use in the company's analyses. Often, there are obvious constraints that will limit growth. One of these constraints is the near certainty that competitors will enter the market if large increases in demand continue for very long.



Cluster Analysis and Other Techniques As multinationals extend their presence to more markets, managers are searching for ways to group countries and geographic regions by common characteristics. **Cluster analysis** divides objects (market areas, individuals, customers, and other variables) into groups so that the variables within each group are similar. For example, a team of college softball players sitting at a table in a restaurant might be a “cluster.” Marketers, for example, use cluster analysis to identify a group of markets where a single promotional approach can be employed; attorneys can use it to group nations according to similarities in certain types of laws; and so forth. In other words, cluster analysis is used to classify a “mountain” of information into meaningful “piles.”

L012-3 Describe some statistical techniques for estimating market demand and grouping similar markets.

Periodic Updating If the estimates are altered appreciably in the periodic updating that all long-term forecasts undergo, managers may change the extent of the firm’s involvement to be in line with the new estimates. Fortunately, the alternative forms of participation in a market permit the firm to become progressively more involved, with corresponding increases in investment. As discussed in Chapter 13, most companies can enter a market in stages, perhaps in this sequence: exporting, establishment of a foreign sales company, local assembly, and, finally, local manufacturing.

cluster analysis Statistical technique that divides objects into groups so that the objects within each group are similar

Even when the decision is whether to produce overseas, management may plan to assemble a combination of imported and domestically produced parts initially and then progressively to manufacture more components locally as demand rises. Automobile manufacturers have begun a number of foreign operations employing this strategy.

THIRD SCREENING—POLITICAL AND LEGAL FORCES

The elements of the political and legal forces that can eliminate a market from further consideration (or make it more attractive) are numerous.

Entry Barriers Import restrictions can be positive or negative, depending on whether managers are considering whether to serve the market by exporting (can the firm’s products enter the country?) or by setting up a foreign plant (will competitive imports be kept out?). If an objective is 100 percent ownership, will the nation’s laws permit it, or is some local participation required? Will the government accept a minority local ownership, or must a minimum of 51 percent of the subsidiary be in the hands of nationals? Are there laws that reserve certain industries for either the government or its citizens?² Is the host government demanding that the foreign owner turn over technology to its proposed affiliate that the foreign owner prefers to keep at the home-country plant? Perhaps the host government has local content restrictions that the prospective investor considers excessive. There may be a government-owned company that would compete with the proposed plant. Depending on the circumstances and how strongly management wishes to enter the market, any one of these conditions may be sufficient cause to eliminate a nation from further consideration.

Profit Remittance Barriers When there are no objectionable requisites for entry, a nation may still be excluded if there are what management believes to be undue restrictions on the repatriation of earnings. Limits linked to the amount of foreign investment or other criteria may be set, or the nation may have a history of inability to provide foreign exchange for profit remittances.

Policy Stability Another factor of importance to management in studying the possibilities of investing in a country is the stability of government policy. Is there continuity in policy when a new leader takes office, for example? What is the political climate? Is the government stable, or is there infighting among government leaders? How about the public? Is there visible unrest? Do the armed forces have a history of intervention when there are public disturbances? Business can adapt to the form of government and thrive as long as the conditions are stable. But instability creates uncertainty, and this complicates planning. An often-heard complaint is, “They’ve changed the rules again.”



It is important to make a distinction between *political stability* and *policy stability*. Rulers may come and go, but if the policies that affect businesses do not change very much, these political changes really may not be important. In fact, if one measures political stability in terms of changes in leadership at the top, the United States is politically unstable compared with many countries!

Sources of analysis on political and policy stability are numerous. Some, such as Stratfor, have already been mentioned. In addition, Business Environment Risk Intelligence S.A. (www.beri.com) and Political Risk Services (www.prsgroup.com) publish rankings that compare countries on the issue of political risk.

FOURTH SCREENING—SOCIOCULTURAL FORCES

A screening of the remaining candidates on the basis of sociocultural factors is next and is often an arduous process. First, sociocultural factors are fairly subjective. Second, data are difficult to assemble, particularly from a distance. The analyst, unless he or she is a specialist in the country, must rely on the opinions of others. It is possible to hire consultants who typically are “old hands” with experience in the country or region. Others may have a particular methodology, such as Clotaire Rapaille, whose approach is mentioned in the Global Debate box elsewhere in this chapter, or Faith Popcorn, whose approach is mentioned in the chapter opening. Also, professional organizations and universities frequently hold seminars to explain the sociocultural aspects of doing business in a particular area or country.

Reading *Overseas Business Reports* (U.S. Department of Commerce), international business publications (*Business International*, *Financial Times*, *The Economist*), and specialized books will augment the analyst’s sociocultural knowledge. The use of a checklist of the principal sociocultural components, many of which are described in Chapter 4, will serve as a reminder of the many factors the analyst must consider in this screening.



Clotaire Rapaille: Charlatan or Code Breaker Extraordinaire in International Market Research?

Clotaire Rapaille is a charlatan—or possibly an advisor your company simply cannot do without. Originally a psychologist treating autistic children in Europe, Rapaille now operates from a mansion in upstate New York, where top management seek his advice on “the code” that will allow them access to the Indian, French, or Norwegian psyche. And from there, this insight should help them understand the motivations that will draw these people to buy their products.

Rapaille’s earlier insights came when comparing French and American attitudes toward cheese. For the French, he says, cheese is alive, and the French would not put cheese in the refrigerator any more than one would put one’s cat in the fridge. Both are “alive.” But for Americans, Rapaille’s insight is that cheese is “dead,” so Americans seal it in a plastic “casket” and put it in a refrigerator, which is really a “morgue.” Americans are more concerned about safety than taste: the French reverse these preferences. So more French than American consumers die from eating cheese: but the Americans eat a relatively sterile and tasteless product, while the French enjoy a variety of cheeses that Americans cannot fathom.

Rapaille was also influential in the development of Chrysler’s PT Cruiser, the retro car that has enjoyed great success. He has, in total, 50 of the *Fortune* 100 firms as clients. His claim is that teams under his direction have “broken the code” for “anti-Americanism,” “China,” “seduction,” the “teen Internet,” and more. A recent excursion to India led him to pronounce that the caste system was simply a “practical” way of signaling to all their places in society. “It’s not a problem, it’s a solution,” he summarizes.

Rapaille displays a certain confidence bordering on arrogance, and he follows a research method that is unusual, to say the least. Rather than relying on focus groups or surveys, he “breaks the code” of certain countries in roughly three-hour sessions. In these sessions, paid



APJGP8 Alamy Images

respondents first discuss the topic of interest; then they are asked to tap into their emotional reactions; and finally Rapaille explores, as he puts it, their “reptilian brain.” It is the last that he finds useful. “Never believe what people say,” Rapaille says. “I want to understand why people do what they do.” Ultimately, he has respondents on the floor in the fetal position, reliving childhood memories.

From this process, he says, he discovers cultural archetypes, which are long lasting, although opinions may change more readily. Former clients have scoffed at him, using “the cheese is dead” as a constant mantra, mocking his methods. For others, the idea that complex attitudes (such as the German code for Americans, which is “John Wayne”) can be summarized in a word or phrase is, well, silly. Yet many of the same clients come back to him—P&G has come back 35 times.

As a manager, would you—or would you not—hire Clotaire Rapaille or his company to assist you in assessing and interpreting international market opportunities?

Sources: Danielle Sacks, “Crack This Code,” *Fast Company*, April 2006, pp. 97–101; www.pbs.org/wgbh/pages/frontline/shows/persuaders/interviews/rapaille.html (accessed June 14, 2011); www.archetypediscoveries.com (accessed June 14, 2011); and “The Last Word: Clotaire Rapaille,” *Newsweek*, international ed., www.msnbc.msn.com/id/4710897 (accessed June 14, 2011).

Although there are many difficulties, it is possible that recent immigrants or students from foreign countries may be used to shed light on potential sociocultural issues. A danger, of course, is that immigrants and students may not be “typical” representatives of their country, and there is also the prospect that they have been affected by their experience living abroad. Therefore, they are not necessarily reliable indicators of the reaction your product might receive from an audience “back home.”

After the fourth screening, the analyst should have a list of countries for which an industry demand appears to exist. However, what management really wants to know is which of these markets seem to be the best prospects for the firm’s products. A fifth screening based on the competitive forces will help provide this information.

FIFTH SCREENING—COMPETITIVE FORCES

In this screening, the analyst examines markets on the basis of such elements of the competitive forces as:

1. The number, size, and financial strength of the competitors.
2. Their market shares.
3. Their marketing strategies.
4. The apparent effectiveness of their promotional programs.
5. The quality levels of their product lines.
6. The source of their products—imported or locally produced.
7. Their pricing policies.
8. The levels of their after-sales service.
9. Their distribution channels.
10. Their coverage of the market. (Could market segmentation produce niches that are currently poorly served?)

Concerning item 10, it may be important to examine regional or ethnic subcultures in a particular foreign market. These subcultures may be natural or at least identifiable segments for which specific marketing programs may be successful. For example, there are sufficient Hispanic, Chinese, and other subcultures in the United States to merit the importation of Latin American and Chinese products into the United States.

Perhaps other countries have significant immigrant or subcultural populations whose needs you already understand and can serve. As an example, Japan has a small but growing population of immigrants from Latin America whose parents emigrated from Japan to Latin America in earlier times. These returnees tend to preserve their Latin heritage in Japan and might provide a market niche for firms whose strength is marketing to Latin Americans rather than to the Japanese.

Countries in which management believes strong competitors make a profitable operation difficult to attain are eliminated unless management (1) is following a strategy of being present wherever its global competitors are or (2) believes entering a competitor's home market will distract the competitor's attention from its home market, a reason for foreign investment that we discussed in Chapter 1.

FINAL SELECTION OF NEW MARKETS

While much can be accomplished through analysis, there is no substitute for personal visits to markets that appear to have the best potential. An executive of the firm or a team of company representatives should visit those countries that still appear to be good prospects. Before leaving, this person or team should review the data from the various screenings along with any new information that the researcher can supply.

On the basis of this review and experience in making similar domestic decisions, the executive or team should prepare a list of points on which information must be obtained on arrival. Management will want the facts uncovered by the desk study (the five screenings) to be corroborated. Management will also expect a firsthand report on the market, including information on competitive activity and an appraisal of the suitability of the firm's present marketing mix and the availability of support services (warehousing, media agencies, credit, and so forth).

Field Trip The field trip should not be hurried; as much or more time should be allotted to this part of the study as would be spent on a similar domestic field trip. The point is to try to develop a “feel” for what is going on, and this cannot be accomplished quickly. For example, while Japanese youths model themselves after American basketball stars by wearing Nike sneakers, it appears that they change into off-brand sneakers when they actually play basketball. As another example, it seems to be relatively more common for men to shop in grocery stores in Chile, as compared with elsewhere in Latin America. And there is not

L012-4 Discuss
the value to business-people of trade missions and trade fairs.

much tradition in East Asia of men taking on the “do-it-yourself” projects for which Home Depot and similar brands are famous. This type of insight is not likely to develop without actual visits to the market.

Government-Sponsored Trade Missions and Trade Fairs When government trade specialists perceive an overseas market opportunity for an industry, they may organize a **trade mission**. The purpose is to send a group of executives from firms in the industry to a country or group of countries to learn firsthand about the market, meet important customers face-to-face, and make contacts with people interested in representing their products. Because of discounted airfares, hotels, and so forth, the cost to the firm may be less than it would pay if it arranged for its personnel to visit on their own. Moreover, the impact of a group visit is often greater than that of an individual company’s visit. Before the mission’s arrival, consulate or embassy officials will have publicized the visit and made contact with local companies they believe are interested. State governments, trade associations, chambers of commerce, and other export-oriented organizations also organize trade missions.

Probably every nation in the world holds a **trade fair** periodically. Usually, each nation has a specifically marked area (Chinese pavilion, Argentine pavilion, etc.) at the fairgrounds where its exhibitors have their own booths staffed by company sales representatives. Trade fairs are open to the public, but during certain hours (generally mornings), entrance is limited to businesspeople interested in doing business with the exhibitors.

While most fairs in developing countries are general, with displays of many kinds of products, those in Europe are usually specialized. A famous example is the annual CeBIT computer and telecommunications trade fair—the largest computer-related trade fair in the world—held annually in Hannover, Germany. Up to 400,000 people made the trip to this show in 2010 to see exhibits from 4,157 exhibitors from 68 countries.³

Besides making contact with prospective buyers and agents (direct sales are often concluded during these meetings), most exhibitors use these fairs to learn more about the market and gather competitive intelligence. They not only receive feedback from visitors to their exhibits but also have the opportunity to observe their competitors in action.

Sometimes Local Research Is Required For many situations, the manager’s field report will be the final input to the information on which the decision is based. Occasionally, however, the proposed human and financial resource commitments are so great that management will insist on gathering data in the potential market rather than depending solely on the desk and field reports.⁴ This would undoubtedly be the position of a consumer products manufacturer that envisions entering a large competitive market of an industrialized country. It might also be the recommendation of the manager making the field trip if he or she discovered that market conditions were substantially different from those to which the firm was accustomed. Often, in face-to-face interviews, information is revealed that would never be written. In these situations, research in the local market not only will supply information on market definition and projection but also will assist in the formulation of an effective marketing mix.

trade mission

A group of businesspeople and/or government officials (state or federal) that visits a market in search of business opportunities

trade fair

A large exhibition, generally held at the same place and same time periodically, at which companies maintain booths to promote the sale of their products



Visitors explore the exhibits at the CeBIT Technology Fair in Hannover, Germany. Besides making sales contacts, most exhibitors use these fairs to learn more about the market and gather competitive intelligence. They not only receive feedback from visitors to their exhibits but also have the opportunity to observe their competitors in action.



Some Tips on International Marketing Surveys

How can companies begin to get that elusive “feel” for a country from survey data? As we mentioned, one way is to do it yourself via surveys and personal visits. Two other methods involve the use of an outside firm. Under one scenario, you can hire an outside firm to do customized research for your firm’s needs. The second involves using surveys that are administered only partially, or not at all, with your specific firm in mind.

Customized Research Many firms that can do multicountry surveys on behalf of clients belong to ESOMAR (www.esomar.org), the European Society of Opinion and Marketing Research. Originally, the member-firms were European, but there are now 5,000 members from more than 100 countries.

Consumer products firms often utilize ethnographic research techniques, sometimes referred to as “corporate anthropology,” to develop detailed understanding. A number of firms

specialize in this type of research. These firms do extensive “on-the-ground” research, watching consumers actually use products, rather than relying on surveys or focus groups. An example of these specialist firms is Point Forward (www.pointforward.com). In one project, Point Forward helped Wrigley examine attitudes toward breath-freshening aspects of chewing gum, leading to a new Wrigley campaign in China. Another firm is EnviroSell (www.envirosell.com), which specializes in research on shopping. A third firm, QualiData Research Inc., found that in Islamic households, men and women’s clothing were usually washed separately.

General Surveys General surveys are not done with a specific firm in mind. There are three types of general survey. The first is the *omnibus survey*. Omnibus surveys are regularly scheduled surveys conducted by research agencies with questions from different clients (i.e., they are wholly or partially “syndicated”). Because several firms contribute questions, the cost is spread across several users, and the surveys are relatively fast. However,

L012-5 Discuss

some of the problems market researchers encounter in foreign markets.

social desirability bias

The custom of politeness toward everyone that can cause respondents to give answers calculated to please the interviewer rather than reflecting the respondent’s true beliefs or feelings

Research in the Local Market When a firm’s research personnel have had no experience in the country, management should probably hire a local research group to do the work. Generally, home-country research techniques may be used, though they may need to be adapted to local conditions. It is imperative, therefore, that the person in charge of the project have experience either in that country or in one that is culturally similar and preferably in the same geographic area.

If secondary data are unavailable, the researchers must collect primary data, and here they face other complications caused by *cultural problems* and *technical difficulties*.

Cultural Problems. If the researchers are from one culture and are working in another, they may encounter some cultural problems. When they are not proficient in the local language or dialect, the research instrument or the respondents’ answers must be translated. As we learned in Chapter 4’s discussion of sociocultural forces, a number of languages may be spoken in a country, and even in countries where only one language is used, a word’s meaning may change from one region to another.

Other cultural problems plague researchers as they try to collect data. Low levels of literacy may make the use of mail questionnaires virtually impossible. If a husband is interviewed in a market where the wife usually makes the buying decisions, the data obtained from him may be worthless. Nor is it always clear who should be interviewed. Respondents sometimes refuse to answer questions because of their general distrust of strangers. In other instances, the custom of politeness toward everyone will cause respondents to give answers calculated to please the interviewer; this is known as **social desirability bias**.

Often, people have practical reasons for not wanting to be interviewed. In some countries, income taxes are based on the apparent worth of individuals as measured by their tangible assets. In such countries, when asked if there is a stereo or TV in the household, the respondent may suspect the interviewer of being a tax assessor and refuse to answer.



these surveys can ask only a limited number of questions that are directly relevant to a particular client, and the sample may not be representative of a particular firm's potential target market.

One example of a firm involved in administering omnibus surveys is A.C. Nielsen (www.acnielsen.com). Although we may know Nielsen best from the "Nielsen ratings," its TV-watching media measurement service, the firm offers services in more than 100 countries. Nielsen does an omnibus survey in China, among other countries. Another familiar firm—the Gallup Organization (www.gallup.com)—is also involved in this type of research in a variety of countries.

In the second type of noncustomized general survey, market research firms do surveys of their own design and whose results they then market to a variety of firms. An example is the Asian Pacific Consumer Confidence Poll in 13 Asian Pacific markets, a Nielsen survey. Nielsen can even track TV-watching habits in China and India. Another firm that does industry-level surveys spanning a number of countries for general sale is Frost & Sullivan (www.frost.com).

Nonprofit Surveys The third type of survey is administered by a government or nongovernment agency, generally not for profit. The Eurobarometer surveys ([http://ec.europa.eu/public_opinion/](http://ec.europa.eu/public_opinion/index_en.htm)

[index_en.htm](http://ec.europa.eu/public_opinion/index_en.htm)) are administered several times a year to thousands of respondents in European countries, under the auspices of the European Commission. Recent reports of Eurobarometer results with implications for consumer behavior include reports on attitudes toward vacations, food product safety, young people and drugs, and the family. Although these surveys are not specifically directed toward consumption issues, they are free and may be useful. A similar survey, called a *barómetro*, is conducted annually in 18 Latin American countries (www.latinobarometro.org).

The Internet Internet research is increasingly an option, and we are gradually moving toward a time when the technology of Internet surveys may offer any firm the opportunity to do its own surveys anywhere in the world. For example, in 2007 Publicis Groupe used the Internet to tap into French voters' views on French presidential elections. The use of the Internet allowed the firm to set up a blog as a substitute for a three-hour focus group session. The blog allowed participants to discuss their opinions over a two-week period. By the end of the survey period, the consensus had changed: Nicolas Sarkozy moved from "scary" as an unknown to someone articulating the need for change in France. Not only did the longer period result in a change of opinion, but 250 participants could be involved.

To overcome such a problem, experienced researchers often hire college students as interviewers because their manner of speech and their dress correctly identify them as what they are.

Technical Difficulties. As if the cultural problems were not enough, researchers may also encounter technical difficulties. First, up-to-date maps are often unavailable. The streets chosen for sampling may have three or four different names along their length, and the houses may not be numbered. In Japan, a grid system is used for addresses, and, it is said, only cab drivers can find street addresses. Telephone surveys can be a formidable undertaking.⁵

Mail surveys can be troublesome too, because mail deliveries within a city may take weeks or sometimes not made at all. For instance, the postal service in Italy has sometimes been so slow (two weeks for a letter to go from Rome to Milan) that some Italian firms have used private couriers to go to Switzerland to dispatch their foreign mail. The response to a mail survey is often low if the respondent must go to the post office to mail a letter. To increase returns, firms often offer such premiums as lottery tickets or product samples to persons who complete a mail questionnaire.

Research as Practiced The existence of hindrances to marketing research does not mean it is not carried out in foreign markets. As you might surmise from the discussion of the availability of secondary data, marketing research is highly developed in many areas where markets are large and incorrect decisions are costly. Problems like the ones we have mentioned are prevalent in the developing nations, but they are well known to those who live there. It does not take long for the newcomer to become aware of them either, because longtime residents are quick to point them out.

Analysts tend to do less research and use simpler techniques in these nations because often the firm is in a seller's market, which means everything produced can be sold with a minimum of effort. Moreover, competition is frequently less intense in developing nations because (1) there are fewer competitors and (2) managements are struggling with problems other than marketing, which keep them from devoting more time to marketing issues. Even in Mexico, an important market for American firms, marketing research is less popular.⁶ Although the situation

L012-6 Discuss
the different options
for collecting survey-
based research.

is changing, the most common technique continues to be a combination of trend analysis and the querying of knowledgeable persons such as salespeople, channel members, and customers. Researchers then adjust the findings on the basis of subjective considerations.

L012-7 Explain

the difference between country screening and segment screening.

Segment Screening

As was mentioned earlier, when a company intends to do business in several countries, managers can choose two broad market screening approaches: country or segment. In the first approach, Brazil may be viewed as a target market segment. Using the second approach, while Brazil is the physical location of a large group of consumers, the important variables for segmentation are commonalities in needs and wants among consumers *across nationalities*. These consumers may reside in different countries and speak different languages, but they have similar desires for a product or service. From this perspective, age, income, and psychographics (lifestyles) are the essential means of identifying market segments. The relevant marketing question is not where consumers reside but whether they share similar wants and needs. The targeted consumers may be global teens, middle-class executives, or young families with small children: each of these segments may share wants and needs across borders. An example comes from “phone surfers”—young Japanese who actively use their mobile phones to surf the Internet. The small phone screen and tiny keys may be a turnoff for older computer users in the West who have frequent and easy access to desktop or laptop PCs. But youngsters in the West have grown up with Nintendo DS devices, cell phone texting, and iPod nanos, and they readily adapt to the small screens and tiny buttons that are a part of using cell phones as an Internet device. On the other hand, baby boomers—whether in London, Los Angeles, or Lima, Peru—resist the thought of needing hearing aids. Swiss-based Phonak Group makes aids in 15 colors, fashions them like an ear phone, and calls them a “personal communication assistant” around the world. Also, because women around the world are buying similar clothing and cosmetics on the Internet, beauty regimens are becoming more universal.

Because we usually organize the world mentally in terms of countries, we naturally tend to want to analyze markets as country segments. It is much more difficult to think of ourselves as market segments that extend across borders. Also, as was mentioned in the discussion of sociocultural differences, these data can be difficult to secure. Nonetheless, it is important to do this because this approach is the logical outgrowth of the marketing concept. And the fact that certain types of data are difficult to gather does not mean that the data can be ignored. There is an old saying about research: “if you can count it, that ain’t it.” In our context, the easy-to-generate data are not necessarily the important data.

CRITERIA FOR IDENTIFYING AND ASSESSING SEGMENTS

Among the criteria managers should use when identifying and assessing segments, it is important that these segments be:

1. *Definable*. We should be able to identify and measure segments. The more we rely not on socioeconomic indicators but on lifestyle differences, the more difficult this becomes, but the more accurate the resulting analysis is likely to be.
2. *Large*. Segments should be large enough to be worth the effort needed to serve a segment. Of course, as we get closer to flexible manufacturing, the need to find large segments is beginning to recede. Further, the segments should have the potential for growth in the future.
3. *Accessible*. If we literally cannot reach our target segment for either promotional or distribution purposes, we will be unsuccessful.



Ronny Cheng-Ruggeberg: Risk It!



I was born in Austin, Texas, but raised in Berkeley, California. Growing up, I traveled and moved around quite a bit, living in Arizona and Connecticut, and I frequently visited Austin to spend time at my father's famous restaurant, Chinatown. In my junior year of high school, I had planned to major in mechanical engineering; I attended the National Student Leadership Conference at the University of Maryland—

College Park to study just that. I spent three months bored out of my mind sitting through those lectures on engineering, and that's when I realized that I needed more excitement in my life than theorems and calculus could provide. This ultimately led to my decision to study international business and marketing at Cal Poly—San Luis Obispo and to eventually study abroad in Madrid, Spain.

While studying in Madrid, I traveled throughout Europe and have even made a return visit since then and visited many other cities and countries. I have also had the opportunity to do marketing work for a software company based out of Australia, and I am currently the channel marketing manager for a software company based out of Ireland. The best part of all of the international work and travel I have done has been the experiences. There's nothing more exciting than being able to climb up to the Acropolis in Athens, see a live bullfight in Madrid, or experience a soccer riot after a Real Madrid victory!

I have had quite a bit of international experience, and the best advice I can give is to keep an open mind, have a sense of humor, and learn from your mistakes. Don't go into another country with the mind-set that your culture is right and theirs is wrong, because you won't enjoy yourself and you'll experience nothing but conflict. Whether it's work or day-to-day life, everybody makes mistakes, and what matters is how you react and learn from them. The faster you are able to laugh at any mistakes you make and learn, the easier it is to adapt to a new culture and environment. Working and traveling internationally can be the most rewarding experience, but you have to risk it to get the biscuit. You have to forget about any hang-ups you may have, because the greatest stories and accomplishments don't happen from sitting on your butt because you are too scared to go out and seek adventure.

Resources for Your Global Career

Analyzing foreign markets and international projects is important for making decisions on expanding globally. These include tools to analyze market-entry projects including, but not limited to, demographics, economic structure, transportation infrastructure, and local and foreign competition. In any building process, the right tools are necessary to get the job completed. The end result is minimizing risk to increase profitability. Here are a number of solid analytical tools and skills that can be applied to analyzing global markets. If you understand how to use them

and apply them appropriately, you will typically generate higher-quality analytical results and then be able to make better decisions. No tool is ever capable of giving you a clear "go/no go decision," but tools will help temper your judgment and allow you to make a more sound decision.

- The Project Management Process helps you manage complex tasks by identifying goals, setting benchmarks, and establishing timelines for assessing stages of project completion: www.businessballs.com/project.htm and www.method123.com/free-risk-management.php
- Market Development Planning is a project management application for bringing products to new or existing markets including the development and implementation of all related components of the marketing mix: www.businessballs.com/marketdevelopmentservice.htm
- Feasibility studies define the business problem or opportunity, identify and analyze alternative solutions, and recommend a solution to implement: www.readyplanning.com/business_plan_templates/feasibility_study_templates.htm
- SWOT analysis is a tool to analyze virtually any situation a business may encounter by looking at the strengths, weaknesses, opportunities, and threats presented by the situation: www.businessballs.com/swotanalysisfreetemplate.htm
- Porter's Five Forces Model analyzes a company's competitive position and competitive strength in the marketplace: www.businessballs.com/portersfiveforcesofcompetition.htm
- PEST and PESTELI Analysis provide tools to assess and understand a company's growth or decline in their industry: www.businessballs.com/pestanalysisfreetemplate.htm
- PROs & CONs Weighted Analysis is a simple tool to assist in making a "go/no go decision" based on weighted variables in the decision: www.businessballs.com/problemsolving.htm#pro%27s%20and%20con%20list%20decision-making%20template%20example
- Business Plan/Marketing Plan Writing provides information on how to write an effective business or marketing plan. You are unlikely to ever get a project approved or money allocated without a business or a marketing plan. Business and Marketing Plan Templates: www.businessballs.com/freebusinessplansandmarketingtemplates.htm
- Canada/Manitoba Business Service Centre shows you how to write an international business plan and export plan: www.canadabusiness.mb.ca/home_page/information_for_exporters/international_business_plan/

Using Secondary Data and Market Statistics.

High-quality secondary market data and economic statistics about global markets are becoming readily available with just a few keystrokes and will support your market understanding for better application of these tools. Make sure that you have enough analytical data to make a solid recommendation and then you own the recommendation. When you present your

(continued)

recommendations, do it in a clear, succinct, and understandable way. Then you look professional.

Sources of secondary data include:

- International Market Research Reports on more than 130 topics from more than 90 countries: www.internationalbusinessstrategies.com/
- Yahoo Directory for Trade Statistics: http://dir.yahoo.com/business_and_economy/trade/statistics/
- Global Statistics from the Statistics Division of the United Nations: <http://unstats.un.org/unsd/default.htm>
- International Market Research Data: www.marketresearch.com/
- The Global Intelligence Alliance (GIA), News and White Papers on International Market Intelligence: www.globalintelligence.com/

4. *Actionable.* If we cannot bring components of marketing programs (the 4 Ps of product, promotion, place, and price) to bear, we may not be successful. For example, in Mexico, the price of tortillas was formerly controlled by the government. Therefore, competition on the price variable was impossible. Foreigners could not penetrate the Mexican market for the standard tortilla by offering a lower price.
5. *Capturable.* Although we would love to discover market segments whose needs are completely unmet, in many cases these market segments are already being served. Nonetheless, we may still be able to compete. Where segments are completely “captured” by the competition, however, our task is much more difficult.⁷

TWO SCREENING METHODS, RECONSIDERED

In the final analysis, our view of the rest of the world is organized along national lines. However, it may be useful to attempt to leave that viewpoint behind when examining international markets.

With the increasing recognition of the existence of subcultures *within* nations and similarities between subcultures *across* nations, the international businessperson may wish to expand his or her horizon beyond the conventional view of the nation as the relevant “unit of analysis.”

The next chapter takes up a series of related questions. Are our needs and desires becoming more and more alike, or are the differences in consumption preferences between us more relevant than the similarities?

Summary

L012-1 Discuss environmental analysis and two types of market screening.

A complete market analysis and assessment as described in this chapter would be made by a firm that either is contemplating entering the foreign market for the first time or is already a multinational but wants to monitor world markets systematically to avoid overlooking marketing opportunities and threats. Many of the data requirements for a foreign decision are the same as those for a similar domestic decision, although it is likely that additional information about some of the international and foreign environmental forces will be needed. Essentially, the screening process consists of examining the various forces in succession and eliminating countries at each step. The sequence of screening based on (1) basic need potential, (2) financial and economic forces, (3) political and legal forces, (4) sociocultural forces, (5) competitive forces, and (6) personal visits is ordered so

as to have a successively smaller number of prospects to consider at each of the succeeding more difficult and expensive stages. Environmental analysis is a review of the external, environmental forces. Market screening is a method of market analysis and assessment that permits management to identify a small number of desirable markets by eliminating those judged to be less attractive. The two basic approaches are country screening and segment screening.

L012-2 Explain market indicators and market factors.

Market indicators are economic data used to measure relative market strengths of countries or geographic areas, such as economic stability, economic growth rate, and population levels. Market factors are economic data that correlate highly with market demand for a product. The text example is the replacement rate for computers in the United Kingdom.

L012-3 Describe some statistical techniques for estimating market demand and grouping similar markets.

Managers are always searching for ways to group countries by region or geographic clusters. Cluster analysis divides objects (market areas, individuals, customers, and other variables) into groups so that the variables within each group are similar. Trend analysis is another technique used to predict market demand.

L012-4 Discuss the value to businesspeople of trade missions and trade fairs.

Trade missions and fairs allow potential buyers and sellers to explore market potential for their products as they are selling, and to explore import opportunities if they are seeking products.

L012-5 Discuss some of the problems market researchers encounter in foreign markets.

There are both cultural and technical difficulties that await the market researcher in foreign markets. Language and dialect issues may be present. A social desirability bias may be present. Technical difficulties such as lack of up-to-date

maps, unreliable mail service, or unreliable street names may be present, as well.

L012-6 Discuss the different options for conducting survey-based research.

You can do your own survey research or use research done by a firm. Firm research is either customized to your needs or general. General research conducted by nonprofits may be a rich and inexpensive source if it can be adapted to your needs. The Internet holds great potential for customized survey research.

L012-7 Explain the difference between country screening and segment screening.

In country screening, the country is viewed as a target market segment. The assumption is that the population is all the same. Using the second approach, while the country is the physical location of a large group of consumers, the important variables for segmentation are commonalities in needs and wants among consumers *across nationalities*. Segment screening looks at market segments across national borders. Segments should be definable, large, accessible, actionable, and capturable.

Key Words

market screening (p. 302)

environmental scanning (p. 302)

country screening (p. 303)

segment screening (p. 303)

market indicators (p. 305)

market factors (p. 306)

estimation by analogy (p. 306)

trend analysis (p. 306)

cluster analysis (p. 307)

trade mission (p. 311)

trade fair (p. 311)

social desirability bias (p. 312)

Questions

1. Select a country and a product that you believe your firm can market there. Make a list of the sources of information you will use for each screening.
2. What is the basis for the order of screenings presented in the text?
3. A firm's export manager finds, by examining the UN's *International Trade Statistics Yearbook*, that the company's competitors are exporting. Is there a way the manager can learn to which countries the U.S. competitors are exporting?
4. Do a country's imports completely measure the market potential for a product? Why or why not?
5. What are some barriers related to the political and legal forces that may eliminate a country from further consideration?
6. Why should a firm's management consider going on a trade mission or exhibiting in a trade fair?
7. What are the two principal kinds of complications that researchers face when they collect primary data in a foreign market? Give examples.
8. Consider the market segment screening method. Take a lifestyle segment—say, people who like do-it-yourself home decorating. How would the segment screening method suggest that you go about identifying potential foreign markets?
9. You are a consultant to the developers of the Spiderman computer game. You will tell the CEO where the likely overseas markets are. What do you do?
10. Assume that your academic unit (probably a college of business) wants to open a campus in a foreign country and that the dean has asked you to prepare a list of possible countries. How would you go about fulfilling the dean's requirement?

Use the globalEDGE site (<http://globalEDGE.msu.edu/>) to complete the following exercises:

1. The *Market Potential Index* (MPI) is an indexing study conducted by the Michigan State University Center for International Business Education and Research (MSU-CIBER) to compare emerging markets on a variety of dimensions. Provide a description of the indicators used for this index. Which of the indicators would have greater importance for a company that markets MP3 players? Considering the MPI rankings, which developing countries would you advise this company to enter first with such a product?
2. You are working at a firm that operates discount department stores across the United States and Canada. Top management has decided to expand to one of the following markets: France, Germany, Japan, Mexico or the United Kingdom. As part of the market analysis, you are asked to identify potential competitors in each market. Locate the National Retail Federation's *Stores* magazine's ranking of the *Top 250 Global Retailers* by annual sales, and provide a list of the top 10 companies for the latest year available. From this list, which companies (with a discount department store format) have operations in each of the markets you are assessing? Which countries are these companies from?

Minicase: The Sugar Daddy Chocolate Company

Jack Carlson started the Sugar Daddy Chocolate Company five years ago and is now selling about \$1 million annually. Carlson would like to expand sales, but the U.S. market is very competitive. He has a friend with a small business who is now making 20 percent of his sales overseas. He wonders if any chocolates are exported. To find out, he calls a friend of his who is a professor of international business at the university and tells him that he wants to find out if chocolate is being exported. He asks the professor to research the following questions:

1. Is chocolate being exported?
2. Which are the six largest importing nations?
3. Which of these are growing markets?
4. Carlson's export competition would probably come from which countries?

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Entry Modes



Our development strategy adapts to different markets addressing local needs and requirements. We currently use three business strategies: joint ventures, licenses, and company-owned stores.

—*Starbucks Corporation*

13

Market Entry in International Social Media

With the increasing business being done on the Internet, it might seem that anyone can easily become an Internet entrepreneur. In reality, it might be a little more complicated.^a

It's true that there is a worldwide presence on the web. In the United States alone, some \$1.5 billion worth of advertising will be done on social networking sites by 2012, and internationally it is becoming increasingly common for companies to use social media as a key tool for conducting market research.^b Social media sites such as Facebook, Myspace, LinkedIn, and hi5 have extensive foreign operations. For example, Facebook is the top social network in most of the nations it serves, such as the Philippines, Indonesia, Malaysia, Singapore, and Hong Kong, and its percentage penetration of web users ranges from 63 percent to 85 percent in each of those nations.^c

As a result of the international expansion of social networking sites, the French luxury company Cartier began featuring separate pages for its "Love by Cartier" product line on Myspace's sites for the United Kingdom, China, France, Italy, Spain, and Japan. Two things are interesting here. First, because Myspace is best known as a youth site, the advertising of luxury brands seems out-of-place—you wouldn't think the audience would be there. Love by Cartier, after all, also has a campaign on the elite, invite-only social network A Small World, which has a jet-set user base that seems a much more appropriate target for a pricey jewelry brand. But Myspace representatives say their image as a teen hangout is a bit misleading, citing comScore statistics that estimate a quarter of its traffic comes from households with annual incomes greater than \$100,000. Second, Cartier chose to enter Myspace's country-specific sites rather than stay with a single approach. Thus, for example, an Italian will see the site in Italian (written in Italian, not machine translated to Italian).

Yet, even with the international success of sites such as Facebook, in order to achieve deep penetration abroad, perhaps you also need to utilize localized or country-specific sites. This might give you a leg up when it comes to understanding the local environment, especially for younger citizens. In fact, although Facebook serves about 44 percent of the world's Internet users and is the leader in most of the nations it serves, it is not the top social network in a number of key developed and emerging markets, such as India, Brazil, South Korea, Russia, and Japan. Indeed, of the largest networking sites in the world, about half of them

Learning Objectives

After reading this chapter, you should be able to:

- LO13-1** Understand the pros and cons of entering markets as a "market pioneer" versus being a "fast follower."
- LO13-2** Explain the international market-entry methods.
- LO13-3** Discuss why firms export and the options available for indirect and direct exporting.
- LO13-4** Explain the potential benefits and disadvantages of joint ventures and how a company might exercise control over a joint venture, even as a minority shareholder.



are sites whose followers are primarily outside the United States. For example, Orkut has 100 million users, Badoo more than 86 million users, hi5 has an estimated 80 million users, and Odnoklassniki about 45 million users. Among these localized, country- or regional-specific sites are the following:

IN ASIA

In India, Orkut is popular, with nearly 50 percent penetration of the web-user market.^d [Bigadda.com](#) and hi5 are also popular in India (and hi5 also has strong penetration in Mongolia, Thailand, Romania, Jamaica, Central Africa, Portugal, and Latin America). In China, three social networks are popular: [Renren.com](#), [Kaixin001.com](#), and [51.com](#). Facebook's site in China is blocked from that country's 420 million Internet users, although there are rumors that the company is exploring ways to gain approved entry to that market.^e In South Korea, [CyWorld.com](#) is a major site, especially for young adults, and it reaches more than half of all web users in that country. CyWorld has a major music component, and many Korean socialites and celebrities post their tours and news of their work on it. Wretch.cc is a popular site in Taiwan, with nearly two-thirds' penetration of the web-user market, and Mixi.jp is popular in Japan. ZING Me is the leading social network site in Vietnam.

IN EUROPE

[Hyves](#) is the most popular social networking property in the Netherlands, penetrating about two-thirds of the market. The German site [StudiVZ](#) also records strong traffic, with 17 million visitors, and [Grono.net](#) is popular in Poland. [Vkontakte](#) dominates the Russian market with a penetration into about three-quarters of the market (more than seven times greater than Facebook's penetration rate in Russia), while [Odnoklassniki](#) has about 45 million users in Russia and former Soviet republics.^f

IN LATIN AMERICA

Several sites are well-established, including Orkut, hi5, and Wamba. Orkut has more than 70 percent penetration of Brazil's social networking market. Another site that is important in Latin America is Sonico, based in Argentina. In addition, Peru is a hi5 stronghold, and Badoo is particularly strong in Venezuela.

Of course, the "just-around-the-corner" commercial battleground is mobile networking: 88 percent of Latin Americans own a mobile phone, versus the more than 60 percent worldwide average.^g The largest single collection of cell phone users is in China. While American youth have the highest rate of mobile Internet usage, Chinese youth have a 50 percent higher rate of mobile

data usage than is the case for the United States and more than double the rate for Europe.^h

Given the importance of appealing to local tastes, are the obstacles to exporting created by a two-tiered social networking structure—where many citizens access major worldwide sites such as Facebook and Myspace, but also access a local or regional network—significant enough that only the largest companies should attempt to do this?

^hSources for this introductory vignette include: Nyay Bhushan, Berwin Song, and Mark Russell, “Rising in the East: A Guide to the Key Asian Social Networking Services,” *Billboard*, May 24, 2008, p. 20, http://books.google.com/books?id=VxQEAAAAMBAJ&pg=PA20&lpg=PA20&dq=Rising+in+the+East:+A+Guide+to+the+Key+Asian+Social+Networking+Services&source=bl&ots=_ipfto5_l8&sig=LJWb4YVqYvDSLytgCBzbZ30yLxU&hl=en&ei=x_wATrytD4f6swPj25S2DQ&sa=X&oi=book_result&ct=result&resnum=1&ved=0CBkQ6AEwAA#v=onepage&q=Rising%20in%20the%20East%3A%20A%20Guide%20to%20the%20Key%20Asian%20Social%20Networking%20Services&f=false (accessed June 21, 2011); “List of Social Networking Sites,” *Wikipedia*, http://en.wikipedia.org/wiki/List_of_social_networking_websites (accessed June 21, 2011); “German Social Networking Community Reaches 14.8 Million,” www.comscore.com/Press_Events/Press_Releases/2007/09/Social_Networking_Sites_in_Germany (accessed June 21, 2011); and Eric Eldon, “The Latin American Social Networking Wars,” June 3, 2008, <http://venturebeat.com/2008/06/03/>

the-latin-american-social-networking-wars-market-leader-hi5-has-been-growing-but-so-has-facebook-and-sonico/ (accessed June 21, 2011).

^bMichael Stanat, “Social Media, the Future of Market Research?,” www.greenbook.org/marketing-research.cfm/social-media-the-future-of-market-research (accessed June 21, 2011).

^ccomScore, “Social Networking Habits Vary Considerably Across Asia-Pacific Markets,” www.comscore.com/Press_Events/Press_Releases/2010/4/Social_Networking_Across_Asia-Pacific_Markets (accessed June 21, 2011).

^dIbid.

^eJ.P. Mangalindan, “China: Facebook’s Undiscovered Country,” *CNNMoney*, January 17, 2011, <http://tech.fortune.cnn.com/2011/01/17/how-facebook-can-conquer-china/> (accessed June 21, 2011).

^fJay Yarow and Kamelia Angelova, “Chart of the Day: The Countries Facebook Doesn’t Dominate,” September 23, 2010, www.businessinsider.com/chart-of-the-day-facebook-not-popular-in-countries-2010-9 (accessed June 21, 2011).

^gJose Feroso, “U.N. World Report Picks Up Massive Growth in Mobile Phone Ownership,” www.wired.com/gadgetlab/2009/03/report-60-of-wo/ (accessed June 21, 2011); and Euromonitor, International, “Latin America Enjoys Mobile Telephone Boom,” May 28, 2010, <http://blog.euromonitor.com/2010/05/regional-focus-latin-america-enjoys-mobile-telephone-boom.html> (accessed June 21, 2011).

^h“U.S. Youth Have Higher Smartphone Penetration Than Adults,” www.marketingcharts.com/uncategorized/us-youth-have-higher-smartphone-penetration-than-adults-15665/nielsen-smartphone-penetration-jan-2011jpg/ (accessed June 21, 2011).

As you learned in Chapter 1, we can use a variety of names to identify large firms that operate on a multicountry scale: *global*, *multidomestic*, and *international* firm or company; *multinational enterprise (MNE)* or *multinational company (MNC)*; *international company (IC)*; *transnational company*; and even *multicultural multinational company*. Long before companies become any of these, however, they are usually smaller companies with only domestic experience. In this chapter we examine the very start—that is, the entry into international operations. We first examine issues associated with the decision whether to enter a market as a pioneer or as a fast follower. Then we discuss the different methods available for market entry, beginning with nonequity modes of market entry, followed by equity-based modes.

Entering Markets: Should You Be a Market Pioneer or a Fast Follower?

In the opening vignette, we gained some insight into which social networking sites are market leaders today. But we can’t be sure that the same will be true by the time you are reading this book. Across industry after industry, market leaders rise, then plummet, sometimes disappearing completely. Compaq was once the undisputed leader in laptops and is not even a minor player now. Motorola dominated the first generation of cell phones, then its market share dropped precipitously as Nokia overtook it when second-generation cell phones appeared—subsequently, Nokia’s market dominance has been threatened by companies such as Apple as a new generation of “smartphones” replaces second-generation technology. Not all pioneers capitalize on their potential advantages, yet some evidence does suggest that pioneers gain and maintain a competitive edge in new markets. For instance, researchers have found that surviving pioneers hold a significantly larger average market share when their industries reach maturity than do firms that were either fast followers or late entrants in the product category.

On the other hand, as Compaq illustrates, pioneers can certainly fail. One recent study that took failed pioneers into account and averaged their performances with those of the more successful survivors found that, overall, pioneers did not perform as well over the long haul as

LO13-1 Understand the pros and cons of entering markets as a “market pioneer” versus being a “fast follower.”

followers. Of course, what measures are used can be important here: volume and market share are not the only dimensions by which success can be measured. The truth is that there really is little evidence one way or the other concerning the effect of the *timing* of a firm's entry into a new market on its ultimate profitability in that market or the value it generates for shareholders.

In many cases, a firm entering into international markets becomes a follower by default, because a quicker competitor simply beats it by entering into the market first. But even when a company has the capability of being the first-mover, there are possible advantages to letting others go first and shoulder the initial risks while the follower observes the pioneers' shortcomings and mistakes.

A pioneering firm stands the best chance for long-term success in market-share leadership and profitability when (1) the pioneering firm is insulated from the entry of competitors (high-entry barriers), at least for a while, by strong patent protection, proprietary technology (such as a unique production process), or substantial investment requirements; or (2) the firm has sufficient size, resources, and competencies to take full advantage of its pioneering position and preserve it in the face of later competitive entries. Indeed, some recent evidence suggests that organizational competencies such as R&D and marketing skills not only affect a firm's success as a pioneer but also influence the company's decision about whether to be a pioneer in the first place. Firms that lack the competencies necessary to sustain a first-mover advantage may be more likely to wait for another company to take the lead and then enter the market later.

On the other hand, a follower will most likely succeed when there are few legal, technological, cultural, or financial barriers to inhibit entry (low-entry barriers) and when it has sufficient resources or competencies to overwhelm the pioneer's early advantage. The most successful fast followers tend to have the resources to enter the new market on a larger scale than the pioneer. Thus, they can quickly reduce their unit costs and offer lower prices than incumbent competitors.¹

Thus, the evidence is not clear on whether the firm should be first—or nearly first—into a foreign market. Even after that decision, we have other decisions to make regarding which entry mode the firm should use in entering the market first (or not).

L013-2 Explain
the international
market-entry methods.

What Methods Are Available for Entering Foreign Markets?

Once a company has decided to enter into a foreign market, it must decide which of the many different options for market entry would represent the optimal choice for the company's particular circumstances. We first examine nonequity modes of market entry, followed by equity-based modes.

NONEQUITY MODES OF ENTRY

If a company wishes to enter foreign markets through nonequity-based methods, a number of alternatives are available. In this section, we discuss exporting, turnkey projects, licensing, franchising, management contracts, and contract manufacturing as alternatives for non-equity modes of foreign market entry.

Exporting Most firms begin their involvement in overseas business by exporting—that is, by selling some of their regular production overseas. This method requires little investment and is relatively free of risks. It is an excellent means of getting a feel for international business without committing a great amount of human or financial resources.

Benefits of Exporting Many firms, both large and small, engage in exporting for reasons such as the following:

- To serve markets where the firm has no or limited production facilities. Many large multinationals, like DuPont or Procter & Gamble, supply some of their foreign markets by exporting because no firm, no matter how large, can afford to manufacture a complete product line in every country where its goods are sold. Markets without local factories are

L013-3 Discuss
why firms export and
the options available
for indirect and direct
exporting.

supplied through exports from the home country or from a foreign affiliate. In markets of sufficient size to justify the production of some but not all of the product mix, the affiliate will supplement local production with imports. A car plant in a developing nation may produce the least expensive cars and import luxury models. Also, the more vertically integrated plants may export semifinished products that are inputs for the less integrated subsidiaries.

- To satisfy a host government's requirement that the local subsidiary have exports. Governments of developing nations often require that the local affiliate export at least a portion of its output, and some require that it earn sufficient foreign exchange to cover the cost of its imports.
- To remain price competitive in the home market. Many firms import labor-intensive components produced in their foreign affiliates, or export components for assembly in countries where labor is less expensive and import the finished product.
- To test foreign markets and foreign competition inexpensively. This is a common strategy for firms that want to test a product's acceptance before investing in local production facilities. Exports may also enable firms to test market strategies and make adjustments with reduced risk in a smaller market. If the strategy or product fails, the firm can withdraw without having a costly and sometimes damaging failure to the entire firm. There is, however, a downside to this strategy: whatever the firm does in the foreign market may be seen by a competitor. This is especially true for large, global firms such as Unilever and Procter & Gamble. Former P&G CEO Edwin Artzt changed the company's strategy for introducing new products. Rather than postpone a global launch until the firm accumulated marketing experience in a country, P&G began to introduce products on a worldwide basis early in their development to avoid giving competitors time to react in other markets.
- To meet actual or prospective customer requests for the firm to export. This type of accidental exporting is fairly common. A foreign buyer often will search for something it cannot find locally by consulting the Internet or Thomas Net, a website listing North American producers for thousands of products.
- To offset cyclical sales in the domestic market.
- To achieve additional sales, which will allow the firm to use excess production capacity to lower per-unit fixed costs.
- To extend a product's life cycle by exporting to currently unserved markets where the product will be at the introduction stage of the life cycle.
- To respond strategically to foreign competitors that are in the firm's home market by entering their home market.
- To achieve the success the firm's management has seen others achieve by exporting.
- To improve the efficiency of manufacturing equipment, which usually works better at or near full capacity.

If management does decide to export, it can choose between *indirect* and *direct* exporting.

Indirect Exporting **Indirect exporting** is simpler than direct exporting because it requires neither special expertise nor large cash outlays by the company producing the product. Instead, the work of exporting the product is done by other home country-based companies, which can (a) sell for the manufacturer, (b) buy for their overseas customers, (c) buy and sell for their own accounts, or (d) purchase on behalf of foreign middlemen or users. Although each type of exporter usually operates in the manner explained next, any given company may actually perform one or more of these functions.

indirect exporting

The exporting of goods and services through various types of home country-based exporters

A. Exporters That Sell for the Manufacturer

1. *Manufacturers' export agents* act as the international representatives for various non-competing domestic manufacturers. They usually direct promotion, consummate sales, invoice, ship, and handle the financing. They commonly are paid a commission for carrying out these functions in the name of the manufacturer.

2. *Export management companies (EMCs)* act as the export department for several non-competing manufacturers. They also transact business in the name of the manufacturer and handle the routine details of shipping and promotion. When the EMC works on a commission basis, the manufacturer invoices the customer directly and carries any financing required by the foreign buyer. However, most EMCs work on a buy-and-sell arrangement under which they pay the manufacturer, resell the product abroad, and invoice the customer directly. Depending on the arrangement, the EMC may act in the name of the firm it represents or in its own name.
3. *International trading companies* are similar to EMCs in that they also act as agents for some companies and as merchant wholesalers for others. This, however, is only part of their activities. They frequently export as well as import, own their own transportation facilities, and provide financing.

B. Exporters That Buy for Their Overseas Customers

1. *Export commission agents* represent overseas purchasers, such as import firms and large industrial users. They are paid a commission by the purchaser for acting as resident buyers in the exporting nation.

C. Exporters That Buy and Sell for Their Own Accounts

1. *Export merchants* purchase products directly from the manufacturer and then sell, invoice, and ship them in their own names so that foreign customers have no direct dealings with the manufacturer, as they do in the case of an export agent. If export merchants have an exclusive right to sell the manufacturer's products in an overseas territory, they are generally called *export distributors*. Some EMCs may actually be export distributors for a number of their clients.
2. Sometimes called *piggyback exporters*, **cooperative exporters** are established international manufacturers that sell the products of other companies in foreign markets along with their own. Carriers (exporters) may purchase and resell in their own name, or they may work on a commission basis. Carriers, like EMCs, serve as the export departments for the firms they represent.
3. *Webb-Pomerene Associations* are organizations of competing firms that have joined together for the sole purpose of export trade. At this time, there are fewer than 25 such associations. The Motion Picture Association (MPA), which is the legacy of a Webb-Pomerene Association, is the primary organization combating movie piracy around the world.

D. Exporters That Purchase for Foreign Users and Middlemen

1. *Large foreign users*, such as mining, petroleum, and international construction companies, buy for their own use overseas. The purchasing departments of all the worldwide companies are continually buying for their foreign affiliates, and both foreign governments and foreign firms maintain purchasing offices in industrialized countries.
2. *Export resident buyers* perform essentially the same functions as export commission agents. However, they are generally more closely associated with a foreign firm. They may be appointed as the official buying representatives and paid a retainer, or they may even be employees. This is in contrast to the export commission agent, who usually represents a number of overseas buyers and works on a transaction-by-transaction basis.

Drawbacks of Indirect Exporting Indirect exporters pay a price for having another company handle their exports: (1) they pay a commission to the first three kinds of exporters, (2) foreign business can be lost if exporters decide to change their sources of supply, and (3) firms gain little experience from these transactions. This is why many companies that begin in this manner generally change to direct exporting.

Direct Exporting To engage in **direct exporting**, the export business is handled by someone within the firm. The simplest arrangement is to give someone, often the sales manager, the

cooperative exporters

Established international manufacturers that export other manufacturers' goods as well as their own

direct exporting

The exporting of goods and services by the firm that produces them

responsibility for developing the export business. Domestic employees may handle the billing, credit, and shipping initially, and if the business expands, a separate export department may be set up. A firm that has been exporting to wholesale importers in an area and serving them with visits from either home office personnel or foreign-based sales representatives frequently finds that sales have grown to a point that will support a complete marketing organization.

Management may then decide to set up a **sales company** in the area. The sales company imports in its own name from the parent and invoices in local currency. It may employ the same channels of distribution, although the new organization may permit the use of a more profitable arrangement. This type of organization can grow quite large, often invoicing many millions of dollars annually. Before building a plant in Mexico, for many years Eastman Kodak imported and resold cameras and photographic supplies while doing a large business in local film developing. Many firms that began with local repair facilities later expanded to produce simple components. Gradually, they produced more of the product locally until, after a period of time, they were manufacturing all the components in the country.

The Internet has made direct exporting much easier. For the beginning exporter, the possibility of creating awareness that your product will be available abroad is dramatically increased. And although it is likely that a substantial international presence on the Internet will require a significant investment, the cost of trial is now very low.

Distribution Options for Direct Exporters If the firm chooses to do its own exporting but not directly handle distribution in the market it is exporting to, then it has four basic types of overseas middlemen from which to choose: (1) manufacturers' agents, (2) distributors, (3) retailers, and (4) trading companies. These may be serviced by sales personnel who either travel to the market or are based in it. If the sales volume is sufficient, a foreign sales company may be established to take the place of the wholesale importer. The manufacturing affiliates of most worldwide companies also import from home country plants or from other subsidiaries those products that they themselves do not produce.

1. **Manufacturers' agents** are residents of the country or region in which they are conducting business for the firm. They represent various noncompeting foreign suppliers, and they take orders in those firms' names. Manufacturers' agents usually work on a commission basis, pay their own expenses, and do not assume any financial responsibility. They often stock the products of some of their suppliers, thus combining the functions of agent and wholesale distributor.
2. **Distributors**, or *wholesale importers*, are independent merchants that buy for their own account. They import and stock for resale. Distributors are usually specialists in a particular field, such as farm equipment or pharmaceuticals. They may be given exclusive representation and, in return, agree not to handle competing brands. Distributors may buy through manufacturers' agents when the exporter employs them, or they may send their orders directly to the exporting firm. Instead of hiring manufacturers' agents, exporters may employ their own salespeople to cover the territory and assist the distributors. For years, worldwide companies such as Caterpillar and Goodyear have utilized field representatives in export territories.
3. *Retailers*, especially of consumer products, are frequently direct importers. Contact on behalf of the exporter is maintained either by a manufacturers' agent or by the exporter's sales representative based in the territory or traveling from the home office.
4. **Trading companies** are relatively unknown in the United States but are extremely important importers in other parts of the world. In a number of African nations, trading companies not only are the principal importers of goods ranging from consumer products to capital equipment, but also export such raw materials as ore, palm oil, and coffee. In addition, they operate department stores, grocery stores, and agencies for automobiles and farm machinery. Another form of trading company is owned by the state. State trading companies handle exports and imports in North Korea and Cuba, and in noncommunist nations where an industry is a government monopoly, such as petroleum in Mexico, exporters or their agents must deal with these government-owned entities.

sales company

A business established for the purpose of marketing goods and services, not producing them

manufacturers' agents

Independent sales representatives of various noncompeting suppliers

distributors

Independent importers that buy for their own account for resale

trading companies

Firms that develop international trade and serve as intermediaries between foreign buyers and domestic sellers and vice versa`

turnkey project

An export of technology, management expertise, and, in some cases, capital equipment where a contractor agrees to design and erect a plant, supply the process technology, provide the necessary suppliers of raw materials and other production inputs, train the operating personnel, and after a trial run, turns the facility over to the purchaser

licensing

A contractual arrangement in which one firm grants access to its patents, trade secrets, or technology to another for a fee

Turnkey Projects Turnkey project is an export of technology, management expertise, and, in some cases, capital equipment. The contractor agrees to design and erect a plant, supply the process technology, provide the necessary suppliers of raw materials and other production inputs, and then train the operating personnel. After a trial run, the facility is turned over to the purchaser.

The exporter of a turnkey project may be a contractor that specializes in designing and erecting plants in a particular industry, such as petroleum refining or steel production. It may also be a company in the industry that wishes to earn money from its expertise by delivering a plant ready to run rather than merely selling its technology. Another kind of supplier of a turnkey project is the producer of a factory.

Licensing Frequently, worldwide companies are called on to furnish technical assistance to firms that have sufficient capital and management strength. By means of a **licensing** agreement, one firm (the licensor) will grant to another firm (the licensee) the right to use any kind of expertise, such as manufacturing processes (patented or unpatented), marketing procedures, and trademarks for one or more of the licensor's products.

The licensee generally pays a fixed sum when signing the licensing agreement and then pays a royalty of 2 to 5 percent of sales over the life of the contract (five to seven years with an option for renewal is one common way to structure such agreements). The exact amount of the royalty will depend on the amount of assistance given and the relative bargaining power of the two parties. In 2009, the total paid to American firms in foreign royalties and license fees amounted to \$90 billion.²

In the past, licensing was not a primary source of income for international firms due to patent infringement, which can be considered a form of piracy. Licensing has changed in recent years, however, especially in the United States, because (1) the courts began upholding patent infringement claims more than they used to, (2) patent holders became more vigilant in suing violators, and (3) the federal government pressed foreign governments to enforce their patent laws.

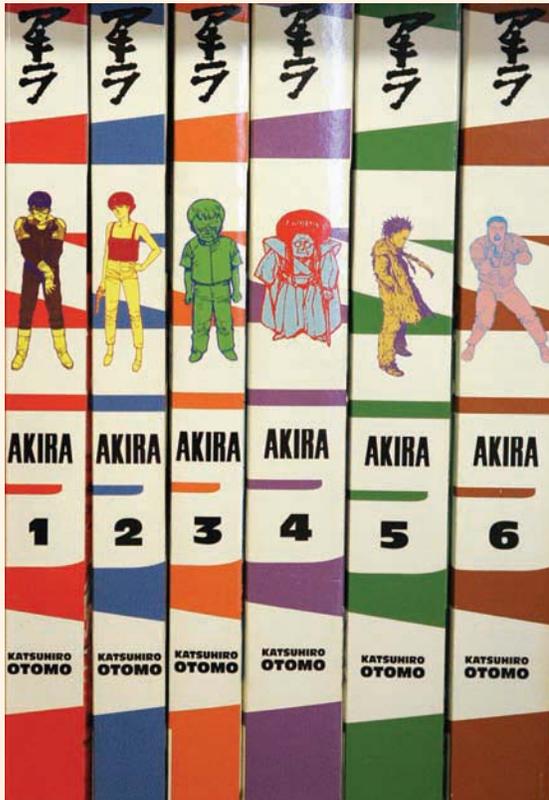
As a result, more companies at home and abroad began to obtain licenses instead of making illegal copies. Texas Instruments (TI), for example, sued nine Japanese electronics



A woman sits beside her stall with Pierre Cardin shirts on a Hanoi street in June 2004. The shirts are made under French designer Pierre Cardin's firm license by a local garment factory. Each shirt sells for around 10 US dollars.



Piracy as a Means of Foreign Market Entry



Although we discuss elsewhere in this chapter the threats to companies from piracy of intellectual property such as brand names or patented technology, piracy can also contribute to the global spread of a product—sort of market entry by accident.^a

Japanese *anime* has estimated global sales of \$80 billion, 10 times what it was a decade ago. Former Japanese Prime Minister Junichiro Koizumi once called it the “savior of Japanese culture.” Disney has purchased the American rights to a number of anime films. The Cartoon Network shows several anime series as part of its Adult Swim programming. TOKOPOP will publish 400 volumes of translated Japanese comics for U.S. consumption.

Two decades ago, there was no U.S. market for Japanese anime. The change occurred not through a concerted push from Japanese media companies but in response to American fans who pulled anime in.

Although Japanese anime was exported to the West in the early 1960s, some saw it as inappropriate for American children, and by the late 1960s it was available only in Japanese overseas communities. The advent of the videotape recorder allowed dubbing and sharing, and soon anime fans were contacting both Japanese citizens and American soldiers stationed in Japan for tapes. Fan clubs emerged as essentially lending libraries and dubbing

centers. In the late 1980s and 1990s, amateurs began dubbing these tapes into English: this “fansubbing” spread. In the early 1990s, large-scale anime conventions brought artists and distributors from Japan, who were astonished to see this thriving content they had never marketed. They returned to Japan ready to service this market commercially. The fan clubs continued their operations, but stopped fansubbing and distributing titles as they became commercially available.

This “piracy” is now supported by the commercial industry, which in fact sponsors events where fan-made *manga*,^b a highly derivative version of the commercial product, is sold. The media companies use these events to publicize their own releases, spot new talent, and monitor shifts in audience tastes.

The idea that some piracy actually helps to diffuse new products is not limited to Japanese anime. It has also been tested for software.

Careful analysis actually found that software piracy is not necessarily harmful to a software firm seeking to launch a new product, because it establishes initial adopters (pirates) and speeds up software diffusion: these initial adopters then influence others to buy the product. Generally speaking, however, as the product diffuses in the market, the level of protection against piracy should be increased.

In a third industry, an international sample across 25 countries suggested that piracy of theatrical movies was actually slightly beneficial to the movie industry!

Questions:

1. How can piracy help a company to successfully, and profitably, enter foreign markets?
2. Consider the case of a small or medium-sized company that was producing software or applications for use on cell phones. If you were asked by this company to assist them in developing a strategy for using piracy as a means of entering foreign markets, what advice would you give them regarding how to successfully develop and implement such a strategy?

^aSources for this box include: Henry Jenkins, “When Piracy Becomes Promotion,” *MIT Technology Review*, August 10, 2004, www.technologyreview.com/biomedicine/13722/ (June 21, 2011); Ernan Haruvy, Vijay Mahajan, and Ashutosh Prasad, “The Effect of Piracy on the Market Penetration of Subscription Software,” *Journal of Business* 77, no. S2 (April 2004), pp. S81–S107; Ashutosh Prasad and Vijay Mahajan, “How Many Pirates Should a Software Firm Tolerate? An Analysis of Piracy Protection on the Diffusion of Software,” *International Journal of Research in Marketing* 20, no. 4 (2003), pp. 337–53, www.sciencedirect.com/science/article/pii/S0167811603000491 (June 21, 2011); TorrentFreak, “Internet Piracy Boosts Anime Sales, Study Concludes,” <http://torrentfreak.com/internet-piracy-boosts-anime-sales-study-concludes-110203/> (June 21, 2011); and Sung Woo Ji, “Piracy Impact on the Theatrical Movie Industry,” www.allacademic.com/meta/p172966_index.html (accessed July 4, 2008).

^bAnime in Japan refers to an animated film, and *manga* is a printed cartoon.

manufacturers for using its patented processes without paying licensing fees. The defendants have paid TI more than \$1 billion since 1986. Although the company does not publish its royalty receipts in its income statements, here's an idea of the magnitude of the earnings from royalties associated with TI's 6,000 patents: TI announced 10-year agreements with both Hyundai Electronics and Samsung Electronics projected to yield royalty payments of more than \$1 billion.

Technology is not the only thing that is licensed to support a firm's market entry. In the fashion industry, a number of designers license the use of their names. Pierre Cardin, one of the largest such licensors, reported more than 400 licenses in more than 170 countries for thousands of different products, ranging from a broad range of clothing to such items as skis, frying pans, sardines, floor tiles, and silk cigarettes. These licenses have earned the company approximately \$75 million annually. As Cardin himself commented, "If someone asked me to do toilet paper, I'd do it. Why not?"³

Are you giving Coca-Cola free advertising on your T-shirt? The company's manager for merchandise licensing expects the company to make millions from an agreement with the founder of Gloria Vanderbilt. He says the firm agreed to the arrangement because "clothes enhance our image. The money is not important."

Another industry, magazine publishing, is licensing overseas editions. For example, you can buy *Cosmopolitan* in more than 100 countries, and it is printed in 32 different languages.⁴ *Playboy* is available in 23 different international editions, including in the Islamic nation of Indonesia.⁵

Despite the opportunity to obtain a sizable income from licensing, many firms, especially those that produce high-tech products, still will not grant licenses. They fear that a licensee will become a competitor upon expiration of the agreement or that the licensee will aggressively seek to market the products outside its home territory. At one time, licensors routinely inserted a clause in the licensing agreement that prohibited exports, but most governments will not accept such a prohibition.

franchising

A form of licensing in which one firm contracts with another to operate a certain type of business under an established name according to specific rules

Franchising Firms have also gone overseas with a different kind of licensing—**franchising**. Franchising permits the franchisee to sell products or services under a highly publicized brand name and a well-proven set of procedures with a carefully developed and controlled marketing strategy. Of some 500 U.S. franchisors with approximately 50,000 outlets worldwide, fast-food operations (such as McDonald's, KFC, Subway, and Pizza Hut) are the most numerous. Other types of franchisors are hotels (Intercontinental), business services (Muzak, The UPS Store), fitness (Curves, Jazzercise), building maintenance (Service-Master, Nationwide Exterminating), and real estate (ReMax).

management contract

An arrangement by which one firm provides management in all or specific areas to another firm

Management Contract The **management contract** is an arrangement under which a company provides managerial know-how in some or all functional areas to another party for a fee that typically ranges from 2 to 5 percent of sales. International companies make such contracts with (1) firms in which they have no ownership (e.g., Hilton Hotel provides management for nonowned overseas hotels that use the Hilton name, and Delta provides management assistance to foreign airlines), (2) joint venture partners, and (3) wholly owned subsidiaries. The last arrangement is made solely for the purpose of allowing the parent to siphon off some of the subsidiary's profits. This becomes extremely important when, as in many foreign exchange-poor nations, the parent firm is limited in the amount of profits it can repatriate. Moreover, because the fee is an expense, the subsidiary receives a tax benefit in the foreign subsidiary's country. This practice may also allow the parent firm to better manage its corporate-wide tax burden by reducing profits within higher-tax nations and moving them instead to countries with lower tax rates.

contract manufacturing

An arrangement in which one firm contracts with another to produce products to its specifications but assumes responsibility for marketing

Contract Manufacturing International firms employ **contract manufacturing** in two ways. One way is as a means of entering a foreign market without investing in plant facilities. The firm contracts with a local manufacturer to produce products for it according to its specifications. The firm's sales organization markets the products under its own brand.

The second way is to subcontract assembly work or the production of parts to independent companies overseas. Although the international firm has no equity in the subcontractor, this practice does resemble foreign direct investment. When the international firm is the largest or only customer of the subcontractors, it has in effect created in another country a new company that generates employment and foreign exchange for the host nation. Frequently, the international firm will lend capital to the foreign contractor in the same way that a global or multinational firm will lend funds to its subsidiary. Because of these similarities, this practice is sometimes called *foreign direct investment without investment*.

EQUITY-BASED MODES OF ENTRY

When management does decide to make a foreign direct investment, it usually has several alternatives available, though not all of them may be feasible in a particular country:

1. Wholly owned subsidiary
2. Joint venture
3. Strategic alliances

Wholly Owned Subsidiary A company that wishes to own a foreign subsidiary outright may (1) start from the ground up by building a new plant (greenfield investment) or (2) acquire a going concern. In the latter instance, a company might even purchase its distributor, thus obtaining a distribution network familiar with its products, although in such a case it will typically be necessary to build production facilities.

Historically, firms making a foreign direct investment have generally preferred wholly owned subsidiaries, but they have not had a marked preference for either of the two means of obtaining them. However, this has not been the case for foreign investors in the United States, who have demonstrated a general preference for acquiring going concerns for the instant access to the market they provide. Moreover, they also have one less competitor after the purchase. In 2008, 93 percent of the \$261 billion that was invested in the United States was used to acquire existing companies, versus spent to create new businesses.

Sometimes it is not possible to have a wholly owned subsidiary in a foreign market. The host government may not permit it, the firm may lack either capital or expertise to

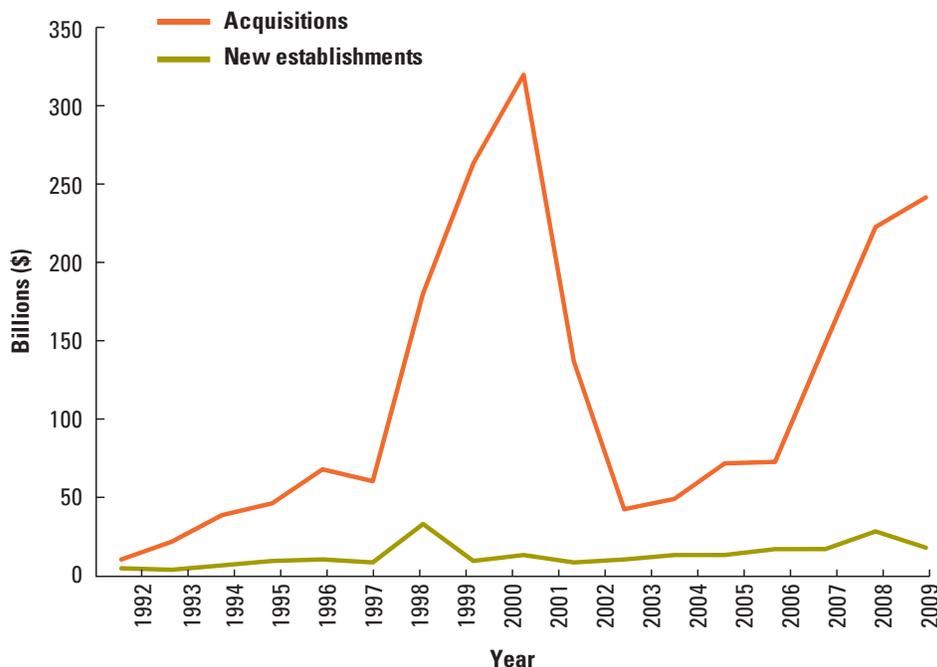


FIGURE 13.1

Investments into the United States for Acquisitions versus New Establishments, 1992–2009

joint venture

A cooperative effort among two or more organizations that share a common interest in a business enterprise or undertaking

L013-4 Explain

the potential benefits and disadvantages of joint ventures and how a company might exercise control over a joint venture, even as a minority shareholder.

undertake the investment alone, or there may be tax and other advantages that favor another form of investment, such as a joint venture.

Joint Venture A **joint venture** may be (1) a corporate entity formed by an international company and local owners, (2) a corporate entity formed by two international companies for the purpose of doing business in a third market, (3) a corporate entity formed by a government agency (usually in the country of investment) and an international firm, or (4) a cooperative undertaking between two or more firms of a limited-duration project. Large construction jobs such as a dam or an airport are frequently handled by this last form.

Benefits of Joint Ventures

Reduced Risk and Competition or Increased Scale Economies Sometimes, forming a joint venture can allow the partners to avoid making expensive and time-consuming investments of their own, while simultaneously helping to avoid dangerous competition with another company. Some firms, as a matter of policy, enter joint ventures to reduce investment risk. Their strategy is to enter into a joint venture with either native partners or another worldwide company. Still others have joined together to achieve economies of scale. Incidentally, any division of ownership in a joint venture is possible unless there are specific legal requirements.

Government Regulations for Local Participation When the government of a host country requires that companies have some local participation, foreign firms must engage in joint ventures with local owners to do business in that country. In some situations, however, a foreign firm will seek local partners even when there is no local requirement to do so.

Strong Nationalism Strong nationalistic sentiment may cause the foreign firm to try to lose its identity by joining with local investors. Care must be taken with this strategy, however. Although a large number of people in many developing countries dislike multinationals for “exploiting” them, they still believe, often with good reason, that the products of the foreign companies are superior to those of purely national firms. One solution to this ambivalence has been to form a joint venture in which the local partners are highly visible, give it an indigenous name, and then advertise that a foreign firm (actually the partner) is supplying the technology. Even wholly owned subsidiaries have followed this marketing strategy.

Expertise, Tax, and Other Benefits Other factors that influence companies to enter joint ventures are the ability to acquire expertise that is lacking, the special tax benefits some governments extend to companies with local partners, and the need for additional capital and experienced personnel.

A Disadvantage of Joint Ventures: Loss of Control Although a joint venture arrangement offers the advantage of a smaller commitment of financial and managerial resources and thus less risk, there are some disadvantages for the foreign firm. One, obviously, is that profits must be shared. Furthermore, if the law allows the foreign investor to have no more than 49 percent participation, it may not have equity-based control. If the stock markets in these countries are small or nonexistent, it is generally impossible to distribute the shares widely enough to permit the foreign firm with its 49 percent ownership position to be the largest stockholder.

Lack of full control over the joint venture is the reason many companies resist making such arrangements. They feel that they must have tight control of their foreign subsidiaries to obtain an efficient allocation of investments and production and to maintain a coordinated marketing plan worldwide. For example, local partners might wish to export to markets that the global company serves from its own plants, or they might want to make the complete product locally when the global company’s strategy is to produce only certain components there and import the rest from other subsidiaries.

In the recent past, numerous governments of developing nations have passed laws requiring local majority ownership for the purpose of giving equity-based control of firms within their borders to their own citizens. Despite these laws, a substantial level of control may still be feasible, even with a minority ownership.

Control of Joint Ventures through Management Contracts Management contracts, which were discussed earlier in this chapter under nonequity-based modes of entry, can enable the global partner to control many aspects of a joint venture even when holding only a minority position. If it supplies key personnel, such as the production and technical managers, the global company can be assured of the product quality with which its name may be associated. It may also be able to earn additional income by selling the joint venture inputs manufactured in the home plant. This is possible because the larger global company is more vertically integrated. A local paint factory, for example, might have to import certain semi-processed pigments and driers that the foreign partner produces in its home country for domestic operations. If these can be purchased elsewhere at a lower price, the local majority could insist on other sources of supply. This rarely happens, because the production and technical managers can argue that only inputs from their employer will produce a satisfactory product, especially if the production machinery being used has been purchased based on specifications from the foreign partner. The production and technical managers are the experts, and they generally have the final word.

Other Options for Exercising Control in Joint Ventures Even as a minority shareholder, a partner company may be able to exercise some control over the joint ventures operations through such mechanisms as supermajority voting requirements (e.g., requiring a two-thirds or more vote in a venture with a 51 percent to 49 percent ownership split in order to approve strategic decisions), maintaining the right to appoint or approve key managerial positions, splitting control of the venture so that each partner may have primary influence over certain key activities (e.g., sourcing of raw materials or components, finance, production, technology), control over or participation in the design and implementation of performance appraisal and reward systems for top management and other personnel of the joint venture, and so forth.

Strategic Alliance Faced with expanding global competition; the growing cost of research, product development, and marketing; and the need to move faster in carrying out their global strategies, many firms are forming **strategic alliances** with customers, suppliers, and competitors. In fact, in a 12-country study, consultants Ernst & Young found that 65 percent of non-U.S. and 75 percent of U.S. companies are engaged in some form of strategic alliance.⁶ The aim of these companies is to achieve faster market entry and startup; gain access to new products, technologies, and markets; and share costs, resources, and risks. Alliances include various types of partnerships and may or may not include equity. Companies wanting to share technology may cross-license their technology, with each licensing its technology to the other. If their aim is to pool research and design resources, they may form an R&D partnership. For example, Nokia and Microsoft formed an alliance in 2011 to collaborate in the development of software for technologically advanced cell phones.

strategic alliance

A partnership between or among competitors, customers, or suppliers that may take one or more of various forms, both equity and nonequity

Alliances May Be Joint Ventures Other companies carry the cooperation further by forming joint ventures in manufacturing and marketing.

Nissan of Japan was a struggling automaker in the 1990s, with \$20 billion in debt and declining market share. Renault of France decided to form an alliance with Nissan rather than merge the companies. Renault sent Carlos Ghosn to become CEO and president of Nissan. Ghosn's team developed and implemented an aggressive turnaround plan, one that has provided benefits for both partners. They have leveraged their size and competencies to enter new markets more rapidly and with lower costs, because they do not need to build new plants. For example, Renault has used Nissan's assembly plants in Mexico, and Nissan uses Renault's Brazilian plant and distribution network. The alliance has increased sales, profitability, and market capitalization for both of the partners. In 2006, these two partners began discussing the possibility of an alliance with another ailing automaker, General Motors of the United States. However, these discussions ended without an alliance.



Joint Venture Challenges: Danone and Wahaha in China

Group Danone SA of France is a major player in the international food and beverage industry, with 90,000 employees spread across five continents. In contrast, the Chinese company Wahaha Group Co. Ltd. was established by Zong Qinhou in the late 1980s as a venture involving three people selling beverages to schoolchildren, later growing into the largest Chinese bottled-water company.

In 1996, Danone and Wahaha agreed to establish a joint venture (JV) in China, eventually expanding to 39 different JVs between them. Danone was the majority owner in the JVs, with a 51 percent share of the equity, and Zong was the chairman of the JVs' boards. Danone had limited involvement in the day-to-day operation of the JVs, delegating this task to Zong and his Chinese management team. In 2006, these ventures generated revenues of \$2 billion and a strong position in the Chinese beverage market. From the outside, this partnership seemed to be a great success.

All was apparently not perfect between the partners, however. By 2005, Danone learned that Zong apparently had been setting up "mirror" businesses that produced and sold products that were nearly identical to those offered by the partners' JVs. These mirror companies, which would be a violation of the JV agreements, even used the Wahaha name to benefit from the JVs' advertisements and sales networks.

Danone negotiated quietly with Zong to resolve the newly discovered problem. In December 2006, an agreement was apparently achieved to combine the mirror companies with the JVs

and to pay \$566 million to Zong. Zong subsequently backed out of the deal, which he claimed to have only signed under "forced" conditions and for an amount far below the mirror companies' value.

After the agreement collapsed in 2007, the disputes between the partners first became public. Danone sought arbitration with Zong in Sweden. Danone also filed lawsuits in the United States and elsewhere for trademark infringement and violation of non-compete clauses. Danone accused Zong of masterminding the fraud with assistance from relatives and offshore entities.

Zong's response was to organize rallies and news conferences that denounced Danone's managers as "rascals" who had committed "evil deeds"; Zong even accused Danone of having engaged in poor treatment of the Chinese. Reflecting an escalation of tensions between the companies, Wahaha executives apparently prevented Danone officials from entering the JVs' buildings.

Zong also filed a request for arbitration in China, in Wahaha's headquarters' city of Hangzhou, arguing that the Wahaha trademark was owned by Wahaha and not the Danone-Wahaha JV. Zong acknowledged that he had signed an agreement with Danone to transfer use of Wahaha's trademark to the JV and to prevent Wahaha from expanding independently into the Chinese beverage market. However, Zong said he never submitted the agreement to the Chinese trademark office for approval, so the agreement never took effect. The Hangzhou Arbitration Commission upheld Zong's assertion that no agreement had been approved by the government and therefore Zong was not prevented from also using the Wahaha trademark or from entering the Chinese beverage market.

pooling alliance

An alliance driven by similarity and integration among partners

trading alliance

An alliance driven by the logic of partners contributing dissimilar resources

Pooling versus Trading Alliances A useful distinction can be made between pooling and trading alliances. **Pooling alliances** are driven by similarity and integration, while **trading alliances** are driven by the logic of contributing dissimilar resources. These two types are typically different in their goals (common versus compatible goals), optimal structures (many versus few partners), and managerial challenges (low versus high coordination needs).⁷

Alliances versus Mergers and Acquisitions Generally mergers and acquisitions are not considered alliances. However, both may be ways for firms to get their hands on new technology, by either acquiring or working with smaller, innovative firms. For example, the merger between Canadian brewer Molson and U.S. brewer Coors was analyzed by many as a union of two "struggling" mid-sized beer companies. The merged company was part of a joint venture with the U.S. operations of SABMiller plc, the maker of Miller beer. Sandoz, a Swiss pharmaceutical manufacturer, acquired Gerber for \$3.7 billion in order to double the size of its food products division. Two years later, because of the increased global competition and the mounting cost of technology, Sandoz and Ciba Geigy, another Swiss drug company, merged to form Novartis, which became the second-largest pharmaceutical firm in the world. Novartis later sold Gerber to Nestlé.

Future of Alliances Many alliances fail or are taken over by one of the partners. The existence of two or more partners—which are often competitors as well as partners and

Several of Zong's companies also sued JV directors nominated by Danone, arguing that they violated non-compete clauses by serving not just on the Danone-Wahaha boards but also on boards of other companies in China that were competing with Wahaha.

Ultimately, the disagreement included at least a dozen lawsuits or arbitration cases filed in a variety of nations, including China, France, Sweden, the United States, Italy, British Virgin Islands, and Samoa. The situation became a major international dispute, including unsuccessful mediation efforts by the leaders of both France and China. Danone's public image and future competitiveness in China were put at risk. Strong feelings of nationalism caused many Chinese consumers and other observers to side with the local Chinese company, Wahaha. Zong was even viewed by some as a national hero for battling heroically against a giant, foreign bully, Danone. Heated debates appeared among Chinese bloggers to promote a boycott of Danone products. At the same time, the Chinese government was concerned about how the Danone-Wahaha dispute might affect the image of China as a desirable destination for international business investment as well as maintaining popular support within China.

In late 2009, Danone agreed to sell its 51 percent share of the JVs to Wahaha for cash and announced that all legal proceedings between the partners were concluded. Danone's CEO and chairman, Frank Riboud, commented, "The collaboration between Danone and Wahaha helped to build a strong and respected leader in the Chinese beverage industry. We are confident that Wahaha will continue to be highly successful under its future management guidance." Wahaha's chairman, Zong, said, "China is an open country. Chinese people are broad-minded people. Chinese companies are willing to cooperate and grow with the world's leading peers on the basis of equality and reciprocal benefit."



Questions:

1. Why do you think the problems arose between Danone and Zong?
2. What might Danone have done to either avoid or reduce the problems that occurred over the life of the JVs?

Sources: Samuel Shen and Jacqueline Wong, "Danone Ends Wahaha Dispute, to Sell China JV Stake," www.reuters.com/article/2009/09/30/us-danone-wahaha-idUSTRE58T12120090930 (June 21, 2011); "Danone v. Wahaha—Which of Us Is the Most China Rookie?," China Law Blog, www.chinalawblog.com/2007/04/danone_v_wahaha_which_of_us_is.html (June 21, 2011); "Danone Settles Dispute with Wahaha," *China Daily*, September 30, 2009, www.chinadaily.com.cn/china/2009-09/30/content_8758022.htm (June 21, 2011); David Barboza, "Danone Exits China Venture after Years of Legal Dispute," *The New York Times*, September 30, 2009, www.nytimes.com/2009/10/01/business/global/01danone.html (June 21, 2011); and Jingzhou Tao and Edward Hillier, "A Tale of Two Companies," *China Business Review*, May–June 2008, pp. 44–47.

typically have differences in strategies, operating practices, and organizational cultures—often causes alliances to be difficult to manage, particularly in rapidly changing international competitive environments.⁸ Alliances can also allow a partner to acquire the firm's technological or other competencies, thereby raising important competitive concerns. The management consulting firm McKinsey & Co. surveyed 150 companies whose alliances with Japanese partners had been terminated. It found that three-quarters of the alliances had been taken over by Japanese partners.

Despite the challenges involved with forming and managing alliances successfully, there is no question that some alliances have accomplished what they set out to accomplish. For example, CFM International, the alliance between General Electric and France's Snecma (Société Nationale d'Étude et de Construction de Moteurs d'Aviation), has been producing jet engines for nearly four decades. It seems that alliances in their various forms will continue to be used as important strategic and tactical weapons, particularly given the financial, technological, political, and other challenges facing companies involved in increasingly competitive international marketplaces.

We began the chapter with a discussion of whether being first in the market meant profitability and discovered that the answer is, "It depends." Whether one is first, an early follower, or a late entrant, there are still chances for success, particularly if a company chooses an appropriate mode of entry and then manages the entry process in an effective manner.



Mark Haupt: A Central California–based International Career



Mark Haupt graduated from Cal Poly with a business degree, concentrating in international business. He loved the area where he went to university and wanted to continue living there, so he put together a career that is both international and allows him to work near home. Here's his story:

I think my interest in international business started when I was little. My father had a job with IBM and he was constantly traveling domestically and internationally. I'm also a big soccer fan and soccer is such a global sport that you start learning more and more about different countries, cities, cultures, etc. . . . and that has always been fascinating to me. I grew up with a lot of different ethnicities and cultures around and it's the differences—and sometimes similarities—that make things interesting to me.

After graduation, I wanted to remain in the Central Coast region of California, near the ocean, but also have international business opportunities. Despite the rural nature of this area, I was able to find a position with a local sporting goods company. I am in charge of our specialty/sporting goods division and my title is "Specialty Sales Manager." I manage a network of sales representatives, domestic and international, as well as select independent accounts and key accounts.

In less than two years with the company, I have worked with customers in more than 30 different nations, including Australia, New Zealand, Canada, Mexico, Colombia, Brazil, Chile, Venezuela, Ireland, England, Germany, Italy, France, the Benelux Region (Belgium, Netherlands, Luxembourg), Scandinavia (Iceland, Sweden, Norway, Finland, Denmark), Romania, Latvia, Belarus, China, Japan, Singapore, Australia, New Zealand, South Africa, Egypt, and Russia. My business association with most of these customers is a distribution arrangement. Companies in these countries distribute my company's products as well as those of other firms.

To prepare for travel, I always like to research the country I am visiting. I start by finding out a little about that country's sport of choice. For me, that's always an easy conversation starter and something that almost everyone has an opinion on. Then I like to find out about popular venues, sights, etc. Finally, I find out what to do or not to do. I research online and talk to people who have already visited the country. I pack light because I never seem to need much besides a few business outfits and some casual clothes. English has been the accepted business language for all my travels, but I like to learn at least a few words of the native language. For me, that shows that I am interested in the country and people

seem to appreciate that. I don't have any routines for when I return from travel. I always seem to take way too long to unpack to the point where I run out of clothes. I am working on that.

To help myself adjust to being away, I always make sure I'm exhausted before I get on the plane. I sleep amazingly well on planes, probably because I have been flying ever since I was little. Usually, I wake up completely refreshed when I arrive.

To make my U.S. location convenient for my international counterparts, I have kept some odd hours. I rely on e-mail, but that usually creates a one-day delay and sometimes doesn't deliver the message effectively. If I use phone or video chat, I try to make the hours work for my customers, which isn't always easy. I have fielded calls as early as 5 A.M. and as late as midnight. That's all part of the job.

My biggest challenge to date has been working on a special order from one of my customers in Asia. Our factory is located in Taiwan, and I have encountered endless complications with molds, materials, packaging, etc. It's easy enough to say you can make a special product and give pricing. It is much more complicated once this actually comes to fruition. For big special orders, it's important that you get everything right. Errors that you might not think about can ruin a project and, potentially, a business relationship.

My greatest international-related enjoyment was going to New Zealand. I loved it over there. The scenery, people, and activities are all amazing. My greatest international business-related enjoyment was starting a relationship with what I first considered to be a mid-sized customer internationally and watching that customer blossom into one of our biggest customers. In sales, you don't always see your efforts pay off. Sometimes you work extra hours and put your heart and soul into something and get nothing out of it. It's extremely satisfying when you put in the extra effort, work extra hours, and it all pays off.

My greatest learning point from my international experience is that I have learned to assume nothing. I have become so incredibly detailed in everything I do because I can never assume that a customer or client understands something exactly the way I do, especially when English isn't their native language. It is much easier to go over something twice in the beginning rather than look back and try to correct a misunderstanding.

My advice for others who are interested in going abroad or working with others who are abroad is the following: if you have the chance, learn any language you can. This is an invaluable asset. Spend some time learning about the countries you are visiting or doing business with, and be extremely inquisitive. Do not act as if you already know everything. It's good to be knowledgeable and worldly, but people love talking about their country and culture and

(continued)

love it when you ask questions and are curious about their lifestyles. Be curious, but not ignorant. Make sure you don't ask anything that might bring up a sore subject.

Resources for Your Global Career

Making the “no go” decision is just as critical as making the “go” decision when considering if your organization should go international. The following articles and tools will assist you in objectively assessing the variables involved in this decision. The wrong decision will be costly to your organization in terms of money, staff time, and your organization’s reputation. Take the time to do the analysis so the decision you make is the right decision. Here are some websites that can help you to make good decisions:

- KPMG’s “Value and International Performance Research” on foreign market entry: www.kpmg.com/hk/en/virtual_library/Consumer_markets/Foreign_market_entry.pdf
- Should you go international? This article from the Washington *Business Journal* provides insight: <http://washington.bizjournals.com/washington/stories/2005/06/06/smallb3.html>
- Six major concerns about going into foreign markets: www.inc.com/magazine/20070401/features-how-to-get-started.html
- Strategies for identifying international markets: www.canadabusiness.ca/eng/88/194/
- Your portal for market-entry assistance: <http://faculty.philau.edu/russowl/market.html>
- How to select which foreign market to enter: http://marketingteacher.com/Lessons/lesson_international_marketing_entry_evaluation_process.htm
- Using FDI as a mode of entry: www.canadabusiness.ca/eng/105/175/ and <http://jobfunctions.bnet.com/abstract.aspx?&docid=76544&promo=110000>
- Modes of foreign market entry: <http://jobfunctions.bnet.com/abstract.aspx?&docid=72028&promo=100511>
- Research on corporate culture as a factor in foreign market-entry decisions: <http://smib.vuw.ac.nz:8081/WWW/ANZMAC2001/anzmac/AUTHORS/pdfs/Evans1.pdf>
- Exporting information from AUSTRADE, the Australian government’s Office of Export Management and Assistance: www.austrade.gov.au/Getting-ready-for-export/default.aspx
- Case study: Campbell Soup Company’s entry strategy into Russia: www.edamba.eu/userfiles/Permiakova.pdf
- Costs of developing foreign markets: www.smallbusiness-notes.com/aboutsb/rs241.html and archive.sba.gov/adv/research/rs241tot.pdf

Summary

L013-1 Understand the pros and cons of entering markets as a “market pioneer” versus being a “fast follower.”

A firm can succeed from any position, as the examples illustrate. In general, however, a follower is more likely to succeed if it has lots of resources. Smaller, less-well-financed followers are less likely to be successful. Pioneers appear to have the best chance for long-term success in market share profitability when they are insulated from entry by competitors due to strong patent protection, proprietary technology, or substantial investment requirements, or if the pioneering firm has sufficient size, resources, and competencies to take full advantage of and preserve its pioneering position in the face of later competitive entry.

L013-2 Explain the international market-entry methods.

Methods of entering foreign markets can be assessed as nonequity- or equity-based situations. Nonequity-based modes of entry include indirect or direct exporting, turnkey projects, licensing, franchising, management contracts, and contract manufacturing. Equity-based modes of market entry include wholly owned subsidiaries, joint ventures, and strategic alliances.

L013-3 Discuss why firms export and the options available for indirect and direct exporting.

Firms can achieve many benefits from exporting, including serving markets where they have no or limited production facilities, responding to host government requirements for exports by local subsidiaries, remain price competitive in the home market,

inexpensively test foreign markets and competitors, meet foreign customer requests, offset cyclical sales in the domestic market, achieve additional sales and utilize excess production capacity, extend a product’s life cycle, respond strategically to foreign competitors that are in the firm’s home market by entering their home market, achieve success observed by other exporters, and improve the efficiency of manufacturing equipment. Indirect exporting can occur through exporters that sell for the manufacturer, exporters that buy for their overseas customers, exporters that buy and sell for their own accounts, and exporters that purchase for foreign users and middlemen. Direct exporting can occur through manufacturers’ agents, distributors, retailers, and trading companies.

L013-4 Explain the potential benefits and disadvantages of joint ventures and how a company might exercise control over a joint venture, even as a minority shareholder.

Joint ventures can allow the partner companies to benefit from reduced risk and competition or increased scale economies; ability to meet government regulations for local participation; respond to strong nationalism, and achieve expertise, tax, and other benefits. A major potential disadvantage of joint ventures is loss of control, but even as a minority shareholder a partner company may be able to exercise some control over the joint venture through management contracts, supermajority voting requirements, appointment of key managers, split control structures, and the design and implementation of performance appraisal and reward systems for the venture’s personnel.

Key Words

indirect exporting (p. 325)

cooperative exporters (p. 326)

direct exporting (p. 326)

sales company (p. 327)

manufacturers' agents (p. 327)

distributors (p. 327)

trading companies (p. 327)

turnkey project (p. 328)

licensing (p. 328)

franchising (p. 330)

management contract (p. 330)

contract manufacturing (p. 330)

joint venture (p. 332)

strategic alliances (p. 333)

pooling alliance (p. 334)

trading alliance (p. 334)

Questions

1. If a company wanted to be a pioneer for entering a market, what conditions might increase the likelihood of success? If the company wanted to instead be a fast follower, what would be different in terms of the conditions that would increase the likelihood of the company's successful entry?
2. What are the methods by which a firm can enter foreign markets?
3. Why might a company want to engage in exporting?
4. What is indirect exporting, and how does it differ from direct exporting? What are the main types of indirect exporting, and what are the primary strengths and weaknesses of each type?
5. What are the distribution options that a direct exporter can use, and what are the primary strengths and weaknesses of each type?
6. What entry mode do fashion designers such as Pierre Cardin, and some high-tech firms like Texas Instruments, share in common? Why might this be an attractive option for entering foreign markets?
7. Under what circumstances might piracy be beneficial to an exporter?
8. Why would a global firm or multinational require that a wholly owned foreign subsidiary sign a management contract when it already owns the subsidiary?
9. Under what conditions might a company prefer a joint venture to a wholly owned subsidiary when making a foreign investment?
10. How can a company control a joint venture if it only has a minority share of the equity?
11. What is the difference, if any, between a joint venture and a strategic alliance?

Research Task



Use the globalEDGE site (<http://globalEDGE.msu.edu/>) to complete the following exercises:

1. *Entrepreneur* magazine annually publishes a ranking of America's top 200 *franchisers* seeking international franchisees. Provide a list of the top 10 companies that pursue franchising as a mode of international expansion. Study one of these companies in detail, and provide a description of its business model, its international expansion pattern, the qualifications it looks for in its franchisees, and the type of support and training it provides.
2. You are working for a computer manufacturer that is planning to set up an assembly unit in Uruguay to serve the region. Because this would involve

importing parts from other countries and then exporting the finished products throughout Latin America, top management has requested information on the trading practices of Uruguay. In particular, these managers want to know (a) the average time to clear both imports and direct exports through Customs; (b) the percentage of losses from direct export due to theft, as well as, breakage; and (c) the percentage of firms identifying Customs and trade regulations as a major constraint. Using *Enterprise Surveys*, a site provided by the World Bank, that measures business perceptions of the investment climate, prepare a brief executive report summarizing your findings. How does Uruguay compare to other countries in Latin America on these measures?

Minicase: Method of Entry—The Foley Company

The Foley Company, a manufacturer of soybean harvesters, has for years sold a substantial number of machines in Brazil. However, a Brazilian firm has begun to manufacture them, and Foley's local distributor has told Jesse Osborne, Foley's president, that if Foley expects to maintain its share of the market, it will also have to manufacture locally. Osborne is in a quandary. The market is too good to lose, but Foley has had no experience with foreign manufacturing operations. Because Brazilian sales and repairs have been handled by the distributor, no one in Foley has had any firsthand experience in that country.

Osborne has made some rough calculations that indicate the firm can make money by manufacturing in Brazil, but the firm's lack of marketing expertise in the country troubles him. He calls in Joanne Poe, the export manager, and asks

her to prepare a list of all the options open to Foley, with their advantages and disadvantages. Osborne also asks Poe to indicate her recommendation.

Questions:

1. Assume you are Joanne Poe. Prepare a list of all the options available to Foley, and give the advantages and disadvantages of each.
2. Which of the options would you recommend? Why?
3. Assuming that the president's calculations are correct and that a factory to produce locally the number of machines that Foley now exports to Brazil will offer a satisfactory return on investment, what special information about Brazil will you want to gather?

Export and Import Practices



The fact that trade protection hurts the economy of the country that imposes it is one of the oldest but still most startling insights economics has to offer. The idea dates back to the origin of economic science itself. Adam Smith's *The Wealth of Nations*, which gave birth to economics, already contained the argument for free trade: by specializing in production instead of producing everything, each nation would profit from free trade.

—Jagdish Bagwati, professor, Columbia University,
The Concise Encyclopedia of Economics

14

How a Box Transformed the World

Fifty years ago, on April 26, a war-surplus oil tanker, the *Ideal-X*, left port in Newark, New Jersey, with a steel frame welded to its deck. The frame held aluminum containers that were off-loaded five days later in Houston, onto trucks. That was the beginning of a revolution in shipping that has made our world smaller. Containerization drastically reduced shipping costs and allowed manufacturers to leave the waterfronts and move, literally, offshore, to take advantage of cheap labor to produce goods that previously could not be exported profitably.

Malcolm McLean, a North Carolina farm boy turned trucker, had hauled cotton bales to Hoboken, where he had to sit around a whole day for his shipment to be unloaded. He waited, and he watched the process. It was slow, hard labor and gave rise to pilferage, as well. His idea was to detach the truck bodies and ship them on boats made to hold them.

No one understood how the box would change everything having to do with export and import, ships and ports, goods traded, trade routes, and labor unions. Marc Levinson, author of *The Box: How the Shipping Container Made the World Smaller and the World Economy Bigger*, calls containerization a monument to the most powerful law in economics, the law of unintended consequences.

Source: Wally Bock, "A Man Who Changed the World," *Monday Memo*, June 11, 2001, www.mondaymemo.net/010611feature.htm (accessed June 16, 2011); Marc Levinson, *The Box: How the Shipping Container Made the World Smaller and the World Economy Bigger* (Princeton, NJ: Princeton University Press, 2006); Marc Levinson, "Unforeseen Consequence: How a Box Transformed the World," *Financial Times*, April 25, 2006, p. 17.

learning objectives

After reading this chapter, you should be able to:

- LO14-1** Identify the sources of export counseling and support.
- LO14-2** Discuss the meaning of the various terms of sale known as Incoterms.
- LO14-3** Identify some sources of export financing.
- LO14-4** Describe the activities of a foreign freight forwarder.
- LO14-5** Outline the export documents required.
- LO14-6** Identify import sources.

There are many reasons to export, as reviewed in the previous chapter. But why do companies *not* export? Two major reasons U.S. firms give for not exporting are a preoccupation with the vast American market and a reluctance to become involved in a new, unknown, and therefore risky operation. When managers of nonexporting firms are probed further on why they are not active in international markets, they generally mention the following three areas in which they lack knowledge: locating foreign markets, payment and financing procedures, and export procedures.

Considerable assistance is available from the federal and state departments of commerce, banks, the Small Business Administration, small business development centers, and private consultants, to mention just a few sources. Too few managers are taking advantage of this valuable assistance. In this chapter, we examine each of the areas that hinder managers in developing exporting capability: locating foreign markets, payment and financing procedures, and export procedures.

Locating Foreign Markets and Developing a Plan

The first step in locating foreign markets is to determine whether a market exists for the firm's products. The initial screening step described in Chapter 12 indicate a procedure to follow that will pose no problem for an experienced market analyst who is well acquainted with the available sources of information and assistance. However, newcomers to exporting, especially smaller firms, may still be at a loss as to how to begin their foreign market research. For them, a number of helpful export assistance programs are available. Once the potential exporter has established that there may be a market for the firm's products, it's time to draft the export marketing plan.

SOURCES OF EXPORT INFORMATION, COUNSELING, AND SUPPORT

Export.gov is the U.S. government's trade portal, established by the Department of Commerce. It brings together resources on exporting from a number of government agencies, including the U.S. International Trade Administration, U.S. Commercial Service, Department of Commerce, Export-Import Bank, Agency for International Development, Small Business Administration, Department of State, and Overseas Private Investment Corporation. Export.gov is packed with case studies of small businesses that have had recent export success and announcement of foreign trade missions and training programs that are open to small businesses.

For firms that already are exporting, the International Trade Administration (ITA) offers a wide range of export promotion activities that include export counseling, analysis of foreign markets, assessment of industry competitiveness, and development of market opportunities and sales representation through export promotion events. Four departments in ITA work together to provide these services:¹

1. *Market Access and Compliance (MAC)*: MAC specialists seek to open foreign markets to American products by developing strategies to overcome obstacles faced by U.S. businesses in foreign countries and regions. They also monitor foreign country compliance with trade agreements.
2. *Manufacturing and Services*: This department promotes the trade interests of American industries by helping to shape industry-specific trade policy. Its industry desk officers work by sector with industry representatives and associations to identify trade opportunities by product or service, industry sector, and market. They also develop export marketing plans and programs. Trade Development experts also conduct executive trade missions, trade fairs, and marketing seminars.
3. *U.S. and Foreign Commercial Service (USCS)*: The USCS has commercial officers working in more than 100 U.S. domestic locations and around 80 countries who can provide background information on foreign companies and assist in finding foreign representatives, conducting market research, and identifying trade and investment opportunities for

L014-1 Identify
the sources of export
counseling and
support.

American firms. The district offices also conduct export workshops and keep business-people informed about domestic and overseas trade events that offer potential for promoting American products.

4. *Import Administration*: This office enforces U.S. trade law and agreements to prevent unfairly traded imports and to safeguard the competitiveness of U.S. businesses.

The Office of International Trade of the Small Business Administration (SBA) offers assistance through SBA district offices to current and potential small business exporters through two programs that are provided in field offices around the country, Business Development and Financial Assistance. The Office of International Trade also works through the SCORE program, in which experienced executives offer free one-on-one counseling to small firms; Small Business Development Centers (SBDCs), located in many universities and colleges, which give export counseling, especially to inexperienced newcomers; Centers for International Business and Research (CIBERs), located in 30 U.S. universities, which also assist firms with exporting; and U.S. Export Assistance Centers, which are one-stop offices ready to help small and medium-size businesses with local export assistance.

The Department of Commerce Export Assistance Program (EAP) helps potential exporters narrow down their potential markets. It has offices in more than 100 U.S. cities and 80 foreign cities. After learning about the company and its products, the EAP international trade specialist might advise the potential exporter to consult the Foreign Trade Division of the U.S. Census Bureau, which tracks trade and economic data from federal agencies. The International Trade Administration of the Department of Commerce provides a comprehensive guide for new exporters and a source of specific product and regional information for experienced exporters searching for new markets.

Once the existence of a potential market is established, the firm must choose between exporting indirectly through U.S.-based exporters and exporting directly using its own staff. If it opts for indirect exporting as a way to test the market, the trade specialist can provide assistance. If the firm prefers to set up its own export operation, it must then obtain overseas distribution. The exporter may use the Export.gov portal to find agents, distributors, or joint venture partners.² Credit reporting agencies, such as Dun & Bradstreet, the Finance, Credit, and International Business Association (FCIB), and the exporter's bank will supply credit information.

If the firm wants to make a foreign trip, Commerce offers the Gold Key Matching Service through many U.S. embassies. This is tailored for managers of American companies who are coming to visit the country and includes orientation briefings, market research, introductions to potential partners, and assistance in developing a marketing strategy for the particular country. The U.S. Commercial Office makes the arrangements. The Foreign Agricultural Service of the U.S. Department of Agriculture offers similar services to potential exporters of agricultural products.

The Department of Commerce also organizes trade events known as "Show and Sells" that are helpful in both locating foreign representatives and making sales. There are four kinds:

1. *U.S. pavilions*: Commerce selects about 100 global trade fairs every year for which it recruits American companies to participate at a U.S. pavilion. Preference is given to fairs in markets suitable for firms that are ready to export. Exhibitors receive extensive support from Commerce in management and overseas promotional campaigns to attract business audiences.
2. *Trade missions*: These focus on an industry sector. Participants are given detailed marketing information, advanced publicity, logistical support, and prearranged appointments with potential buyers and government officials. Generally, a mission consists of 5 to 12 business executives.
3. *Product literature center*: Commerce trade development specialists represent U.S. companies at various international trade shows, where they distribute literature. They then tell the companies who the interested visitors were so that the companies can follow up.
4. *Reverse trade missions*: The U.S. Trade Development Agency may fund visits to the United States by representatives of foreign governments so that they can meet with American industry and government representatives. The foreign officials represent purchasing authorities interested in buying U.S. equipment for specific projects.

In addition to the federal government, other sources of assistance available to the exporter include state governments, all of which have export development programs and many of which have export financing programs. In the private sector, the World Trade Centers Association, a membership organization of more than 300 centers worldwide, provides networking opportunities and an online trading system. There are also industry-based trade groups that are a source of export guidance. In summary, there are many resources for the beginning exporter, and the U.S. government is a good place for U.S. businesses to start building their export knowledge.

MISTAKES MADE BY NEW EXPORTERS

Here is a list of the 12 most commonly made mistakes by new exporters.³ Review them to help you build a sense of where the actual pitfalls are when firms launch export programs.

1. **Failure to obtain qualified export counseling and to develop a master international strategy and marketing plan before starting an export business.** To be successful, a firm must first figure out what its goals and objectives are and develop a plan for how they will be achieved. Unless the firm is fortunate enough to possess a staff with considerable export expertise, taking this crucial first step may require qualified outside guidance.
2. **Insufficient commitment by top management to overcome the initial difficulties and financial requirements of exporting.** Establishing a firm in foreign markets usually takes more time than doing so in domestic ones. Although the early delays and costs involved in exporting may seem difficult to justify compared to the situation in established domestic markets, the exporter should take a long-term view of this process and carefully monitor international marketing efforts through these early difficulties. If a good foundation is laid for export business, the benefits derived should eventually outweigh the investment.
3. **Insufficient care in selecting overseas sales representatives and distributors.** The selection of each foreign distributor is crucial. The complexity introduced by overseas communication and transportation requires that international distributors act with greater independence than do their domestic counterparts. Because a new exporter's history, trademarks, and reputation may be unknown in the foreign market, foreign customers may buy on the strength of a distributor's reputation. A firm should, therefore, conduct a personal evaluation of the personnel handling its account, the distributor's facilities, and the management methods employed.
4. **Chasing orders from around the world instead of establishing a basis for profitable operations and orderly growth.** If exporters expect distributors to promote their accounts actively, the distributors must be trained and assisted, and their performance must be monitored continually. This may require a company executive located in the distributor's geographic region. New exporters may want to concentrate their efforts in one or two geographic areas until they have sufficient business to support a company representative. Then, while this initial core area is expanded, the exporter can move into the next targeted geographic area.
5. **Neglecting export business when the home market booms.** Often companies turn to exporting when business falls off in their home market. When domestic business starts to boom again, they neglect their export trade. Such neglect can harm the profits and motivation of a company's overseas representatives, strangle its own export trade, and leave the firm without recourse when domestic business falls off again.
6. **Failure to treat international distributors and customers on an equal basis with their domestic counterparts.** Often, companies carry out institutional advertising campaigns, special discount offers, sales incentive programs, special credit term programs, warranty offers, and so forth, in the home market but fail to make similar assistance available to their international distributors and customers. This is a mistake that can destroy the vitality of overseas marketing efforts.

7. **Assuming that a given market technique and product will automatically be successful in all countries.** What works in one market may not work in others. Each market has to be treated separately until the company has sufficient knowledge about its export markets to generalize about them.
8. **Unwillingness to modify products to meet regulations or cultural preferences of other countries.** Local safety codes and import restrictions cannot be ignored, nor can cultural preferences. If necessary modifications are not made at the factory, the distributor must make them, often at greater cost and perhaps not as well
9. **Failure to provide service, sales, and warranty information in locally understood languages.** Although many people may speak English, assume that they will want to read instructions and product information in their own language. This holds for customers and distributors.
10. **Failure to consider the use of an export management company.** If a firm decides it cannot afford its own export department, it should consider the possibility of using an export management company (EMC).
11. **Failure to consider licensing or joint venture agreements.** Import restrictions in some countries, insufficient personnel or financial resources, or an overly limited product line can cause many companies to dismiss international marketing as unfeasible. Yet many products that compete on a national basis in a home market can be marketed successfully in many markets of the world through licensing or joint venture arrangements.
12. **Failure to provide readily available servicing for the product.** A product without the necessary service support can acquire a bad reputation in a short period, potentially preventing further sales.

EXPORT MARKETING PLAN

As soon as possible, the firm needs to draft its export marketing plan. An experienced firm will already have a plan in operation, but newcomers may need to wait until they have accumulated at least some information from foreign market research. Essentially, the export marketing plan is the same as the domestic marketing plan. It should be specific about the markets to be developed, the marketing strategy for serving them, and the tactics required to carry out the strategy. Sales forecasts and budgets, pricing policies, product characteristics, promotional plans, and details on arrangements with foreign representatives are required. In other words, the export marketing plan spells out what must be done and when, who should do it, and what the costs are. An outline for an export marketing plan appears in the appendix at the end of this chapter. In Chapter 15 we focus on the marketing mix, but two aspects of the mix require some explanation here: export pricing and sales agreements for foreign representatives.

INCOTERMS

One pricing area of concern for many firms beginning to export is the need to quote **terms of sale** that differ from those used in domestic markets. For foreign transactions, the exporter needs to be familiar with **Incoterms**, 11 three-letter trade terms that describe the responsibilities of the buyer and seller in international trade transactions.⁴ They were created by the International Chamber of Commerce and have recently been revised into two categories, depending on mode of transportation, either general or water. Incoterms describe which party does which tasks, which party covers the costs, and which party bears the risk. For example, FOB means that the seller loads the goods on board the ship nominated by the buyer, clears them for export, and both cost and risk transfer at the ship's rail. Foreign customers will expect one of the following terms of sale, which are briefly described here. Note that these are new terms as of 2011. The responsibilities for various types of foreign sales are more fully described in Figure 14.1.

Two other areas of export differ from domestic sales: pricing and the sales agreement. On pricing, CIF and CFR terms of sale are more convenient for foreign buyers because to establish their cost, they merely have to add the import duties, landing charges, and freight

L014-2 Discuss

the meaning of the various terms of sale known as Incoterms.

terms of sale

Conditions of a sale that stipulate the point at which all costs and risks are borne by the buyer

Incoterms

Universal trade terminology developed by the International Chamber of Commerce

General Transportation Terms

Ex-Works (named place): Seller makes goods available at factory or warehouse, where risk passes.

FCA (named place): Free carrier, seller hands over goods to carrier at a named place, where risk passes.

CPT (named destination): Carriage paid to destination, seller pays for carriage, while risk passes when goods handed to carrier.

CIP (named place of destination): Carriage and insurance paid to destination, while risk passes when good are handed to carrier.

DAT: Delivered at terminal, seller pays for transport and insurance to terminal and has risk until goods loaded at terminal.

DAP (name of destination): Delivered at place; seller pays for carriage to the named place and assumes all risk until goods are unloaded.

DDP (destination place): Delivered, duty paid; seller delivers goods to destination and covers all duties, taxes, customs.

Water Transport Terms

FAS(named loading port): Free alongside ship; seller clears the goods for export and places them by the ship; risk passes at rail.

FOB (named loading port): Free on board; seller loads goods, risk passes at rail.

CFR (named destination port): Cost and freight; seller pays costs of freight and insurance to bring goods to destination port. This does not include insurance. Risk passes once goods are loaded.

CIF (named destination port): Same as CFR, but also includes insurance. Risk still passes at ship's rail.

from the port of arrival to their warehouse. New exporters need to remember the miscellaneous costs—wharf storage and handling charges, freight forwarder's charges, and consular fees—incurred in making a CIF shipment. Note that the domestic marketing and general administrative costs included in the domestic selling price are frequently greater than the actual cost of making a CIF export sale.

FIGURE 14.1

Summary of Seller and Buyer Responsibilities by Incoterm Type of Sale

Incoterms	Load to truck	Export-duty payment	Transport to exporter's port	Unload from truck at port of origin	Landing charges at port of origin	Transport to importer's port	Landing charges at importer's port	Unload from truck from the importer's port	Transport to destination	Insurance	Entry-Customs clearance	Entry-Duties and taxes
EXW	No	No	No	No	No	No	No	No	No	No	No	No
FCA	Yes	Yes	Yes	No	No	No	No	No	No	No	No	No
FAS	Yes	Yes	Yes	Yes	No	No	No	No	No	No	No	No
FOB	Yes	Yes	Yes	Yes	Yes	No	No	No	No	No	No	No
CFR	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No	No	No
CIF	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No	Yes	No	No
CPT	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No
CIP	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No
DAP	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No	No	No	No
DAF	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No	No	No	No
DES	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No	No	No	No
DAT	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No	No	No
DEQ	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No	No	No
DDU	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No
DDP	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes

Sources: Incoterms Wall Chart, 2010, www.winglobal.ca/incoterms_2010 (accessed 16 June, 2011); Wikipedia, <http://en.wikipedia.org/wiki/Incoterms> (accessed June 16, 2011).

The preferred pricing method is the use of the *factory door cost* (production cost without domestic marketing and general administrative costs), to which are added the direct cost of making the export sale, a percentage of the general administrative overhead, and a profit margin. This percentage can be derived from managers' estimates of the part of their total time spent on export matters. The minimum FOB, or Ex-Works, price is the sum of these costs plus the required profit margin. If research in a market has shown that either there is little competition or that competitive prices are higher, then of course the exporter is free to match the competition in that market (price skim) or set a low price to gain market share (penetration pricing). The course of action taken will depend on the firm's sales objectives, just as in the domestic market.

The other area of major difference in exporting is the sales agreement. It should specify as simply as possible the duties of the representative and the firm. Most of what is contained in the contract for a domestic representative can be used in export also, but special attention must be paid to two points: the designation of the responsibilities for patent and trademark registration and the designation of the country and state or province whose laws will govern any contractual dispute. To be absolutely safe, the firm should register all patents and trademarks. Policing them may be left to the local representative; however, the firm should have the help of an experienced international attorney when drawing up an agreement. Exporters from any country are likely to prefer to stipulate the laws of their home country. Many nations, especially those of Latin America, follow the Calvo Doctrine, which holds that cases should be tried under local and not foreign law.

Payment and Financing Procedures

Once new exporters build their understanding of export process, including pricing and the sales agreement, they need to address the issues related to getting paid for their sale, payment and financing procedures. We review the process of export payment and the terms used, approaches to export financing, and other government incentives that have been established to support exporters in the finance area.

EXPORT PAYMENT TERMS

Payment terms, as every marketer knows, are often a decisive factor in obtaining an order. As a sales official of an international grain exporter put it, "If you give credit to a guy who is broke, he'll pay any price for your product." This is somewhat exaggerated, but customers will often pay higher prices when terms are more lenient, especially in countries where capital is scarce and interest rates are high. Among the payment terms offered by exporters to foreign buyers are cash in advance, open account, consignment, letters of credit, and documentary drafts. We'll look at each of these payment methods in turn.

When the credit standing of the buyer is not known or is uncertain, *cash in advance* is desirable. However, very few buyers will accept these terms, because part of their working capital will be tied up until the merchandise has been received and sold. Furthermore, they have no guarantee that they will receive what they ordered. As a result, few customers will pay cash in advance unless the order is for a custom-made product.

When a sale is made on *open account*, the seller assumes all of the payment-related risk, and therefore such terms should be offered only to reliable customers. The exporter's capital is tied up until payment has been received. However, exporters that insist on less risky payment terms, such as a letter of credit, may find that they are losing business to competitors who do sell on open account. Well-known global firms such as Mercedes Benz do not accept the extra cost of obtaining letters of credit and give their business to suppliers that will offer them open-account terms. To establish the buyer's credit, exporters can get credit reports and credit information on foreign firms from several agencies such as Dun & Bradstreet, Owens Online, and Asian CIS.

Consignment means that goods are shipped to the buyer and payment is not made until they have been sold. All of the payment risk is assumed by the seller, so such terms should not be offered without making the same extensive investigation of the buyer and country as that recommended for open-account terms. Multinationals frequently sell goods to their subsidiaries on this basis.

Letter of credit (L/C)

Document issued by the buyer's bank in which the bank promises to pay the seller a specified amount under specified conditions

Only cash in advance offers more protection to the seller than does an export **letter of credit (L/C)**. In an L/C, the bank acts as an intermediary between the seller and buyer. The L/C document is issued by the buyer's bank, which promises to pay the seller a specified amount when the bank has received certain documents stipulated in the letter of credit by a specified time. Generally, the seller will request that the letter of credit be *confirmed* and *irrevocable*. In a **confirmed L/C**, a correspondent bank in the seller's country confirms that it will honor the issuing bank's letter of credit. With an **irrevocable L/C**, once the seller has accepted the credit, the customer cannot alter or cancel it without the seller's consent. Figure 14.2 is an example of a bank's confirmation of an irrevocable letter of credit. If the letter of credit is *not* confirmed, the correspondent bank (Merchants National Bank of Mobile) has no obligation to pay the seller (Smith & Co.) when it receives the documents listed in the letter of credit. Only the issuing bank (Banco Americano in Bogotá) is responsible. If sellers (Smith & Co.) wish to be able to collect from an American bank, they will insist that the credit be confirmed by such a bank. This confirmation is generally done by the correspondent bank, as it is in Figure 14.2. When the Merchants National Bank of Mobile confirms the credit, it undertakes an obligation to pay

FIGURE 14.2

Letter of Credit

THE MERCHANTS NATIONAL BANK OF MOBILE
MOBILE, ALABAMA

FOREIGN DEPARTMENT

Confirmed Irrevocable Straight Credit
Smith & Company
P.O. Box 000
Towne, Alabama 36000

Credit No. 0000
Mobile, Alabama, April 1, 20—

DEAR SIRs:

WE ARE INSTRUCTED BY Banco Americano, Bogota, Colombia

TO ADVISE YOU THAT THEY HAVE OPENED THEIR IRREVOCABLE CREDIT IN YOUR FAVOR FOR ACCOUNT OF
Compañía Santadereana de Automotores Ltda. "Sanautos", Bucaramanga, Colombia

UNDER THEIR CREDIT NUMBER 111-222 **FOR A SUM OR SUMS NOT EXCEEDING A TOTAL OF** \$40,000.00
(FORTY THOUSAND NO/100 U.S. DOLLARS)

AVAILABLE BY YOUR DRAFTS ON US AT Sight **FOR INVOICE**

VALUE OF 100%

TO BE ACCOMPANIED BY

1. Commercial Invoice: five copies signed by the beneficiaries with sworn statement regarding price and origin of merchandise.
2. Air Waybill: three non-negotiable copies, cosigned to the order of: Sanautos, Carrera 15 Calle 29, Bucaramanga, for notification of same.
3. Consular Invoice: three copies.
4. Certificate of Origin: three copies
5. Copy of the airmail letter addressed to: Sanautos, Apartado Aereo No. 936, Bucaramanga, Colombia, remitting original of shipping documents requested.
6. Packing List: three copies.
7. Copy of the airmail letter addressed to: Colombia de Seguros Bolivar, Calle 36, No. 17-03, Bucaramanga, Colombia, covering details of shipment of merchandise, for insurance purposes.

Evidencing shipment of: "Repuestos para vehiculos automotores, registro de importacion No. 67038 del 21 de Noviembre de 19—." Port of Shipment: any American port. Destination: Bucaramanga, Partial shipments are permitted.

ALL DRAFTS SO DRAWN MUST BE MARKED DRAWN UNDER THE MERCHANTS NATIONAL BANK OF MOBILE CREDIT

NO. 0000, Banco Americano No. L/C 111-222

THE ABOVE MENTIONED CORRESPONDENT ENGAGES WITH YOU THAT ALL DRAFTS DRAWN UNDER AND IN COMPLIANCE WITH THE TERMS OF THIS CREDIT WILL BE DULY HONORED ON DELIVERY OF DOCUMENTS AS SPECIFIED IF PRESENTED AT THIS OFFICE ON OR BEFORE June 27, 19— **.WE CONFIRM THE CREDIT AND THEREBY UNDERTAKE THAT ALL DRAFTS DRAWN AND PRESENTED AS ABOVE SPECIFIED WILL BE DULY HONORED BY US.**

UNLESS OTHERWISE EXPRESSLY STATED, THIS CREDIT IS SUBJECT TO THE UNIFORM CUSTOMS AND PRACTICE FOR COMMERCIAL DOCUMENTARY CREDITS FIXED BY SEVENTH CONGRESS OF THE INTERNATIONAL CHAMBER OF COMMERCE AND CERTAIN GUIDING PROVISIONS ALL AS ADOPTED BY CERTAIN BANKS AND OTHER CONCERNS IN THE U. S. A.

YOURS VERY TRULY,

ASSISTANT MANAGER
John Doe, Vice President

VICE PRESIDENT, ASSISTANT CASHIER
Allen Jones, Vice President

cc Banco Americano, Bogota, Colombia

Smith & Co. if all the documents listed in the letter are presented on or before the stipulated date. Note that nothing is mentioned about the goods themselves; the buyer has stipulated only that an **air waybill** issued by the carrier be presented as proof that shipment has been made. Even if bank officials know that the plane had crashed after the takeoff, they would still pay Smith & Co. Banks are concerned with documents, not merchandise.

Before opening a letter of credit, a buyer frequently requests a **pro forma invoice**. This is the exporter's formal quotation containing a description of the merchandise, price, delivery time, proposed method of shipment, ports of exit and entry, and terms of sale. It is more than a quotation, however. Generally, the bank will use it when opening a letter of credit, and in countries requiring import licenses or permits to purchase foreign exchange, government officials will insist on receiving copies.

Figure 14.3 illustrates the routes taken by the merchandise, letter of credit, and documents in a letter of credit transaction between a U.S. seller and a German buyer. When the German buyer accepts the terms of sale that provide for a confirmed and irrevocable letter of credit, she goes to her bank to arrange for opening the required letter. The buyer will furnish the bank with the information contained in the pro forma invoice, specify the documents that the exporter must present to obtain payment, and set the expiration date for the credit. The concept of the L/C is a simple one, the bank as intermediary between buyer and seller. In fact, a simple irrevocable L/C requires 11 steps to clear payment. Here are those steps:⁵

1. After the exporter and buyer agree on the terms of a sale, the buyer arranges for its bank to open a letter of credit that specifies the documents needed for payment. The buyer determines which documents will be required.
2. The buyer's bank issues, or opens, its irrevocable letter of credit includes all instructions to the seller relating to the shipment.
3. The buyer's bank sends its irrevocable letter of credit to a U.S. bank and requests confirmation. The exporter may request that a particular U.S. bank be the confirming bank, or the foreign bank may select a U.S. correspondent bank.
4. The U.S. bank prepares a letter of confirmation to forward to the exporter along with the irrevocable letter of credit.

confirmed L/C

A confirmation made by a correspondent bank in the seller's country by which it agrees to honor the issuing bank's letter of credit

irrevocable L/C

A stipulation that a letter of credit cannot be canceled

air waybill

A bill of lading issued by an air carrier

pro forma invoice

Exporter's formal quotation containing a description of the merchandise, price, delivery time, method of shipping, terms of sale, and points of exit and entry

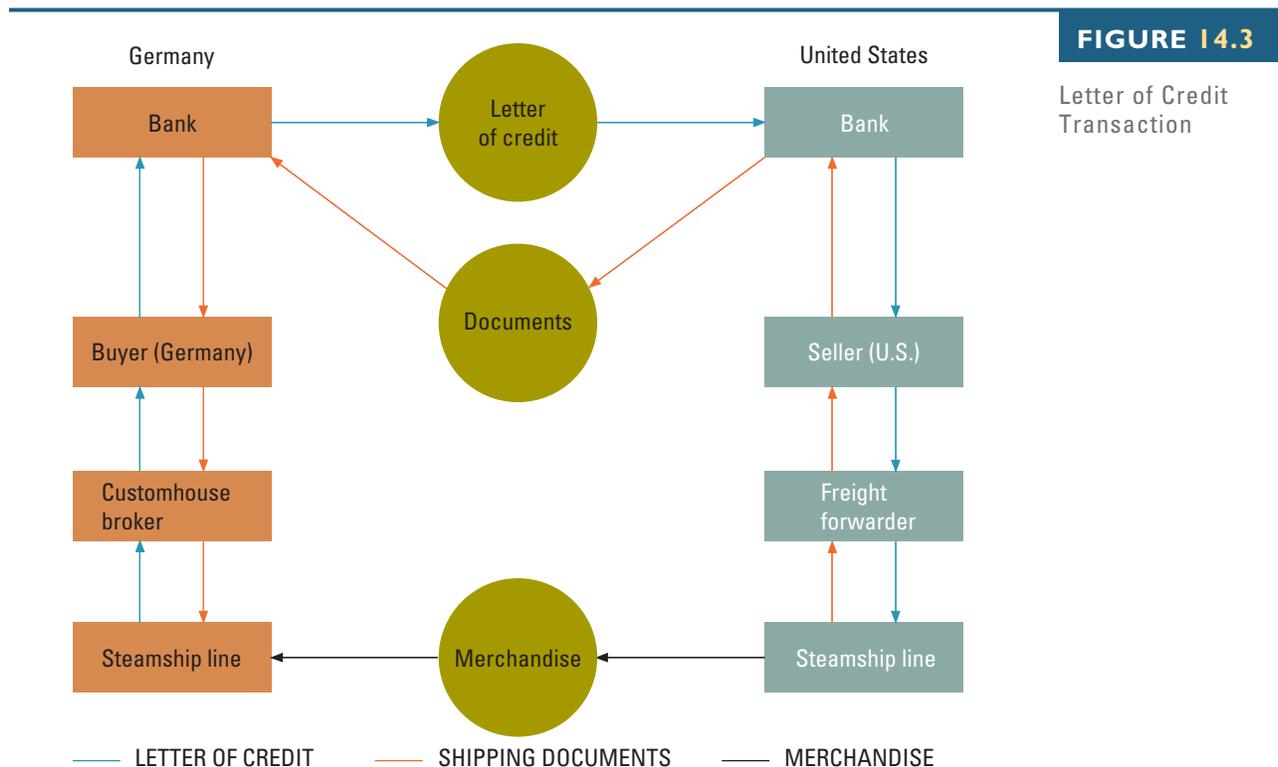


FIGURE 14.3

Letter of Credit Transaction

5. The exporter reviews carefully all conditions in the letter of credit. The exporter's freight forwarder is contacted to make sure that the shipping date can be met. If the exporter cannot comply with one or more of the conditions, the customer is alerted at once.
6. The exporter arranges with the freight forwarder to deliver the goods to the appropriate port or airport.
7. When the goods are loaded, the freight forwarder completes the necessary documentation.
8. The exporter (or the freight forwarder) presents the documents, evidencing full compliance with the letter of credit terms, to the U.S. bank.
9. The bank reviews the documents. If they are in order, the documents are sent to the buyer's bank for review and then transmitted to the buyer.
10. The buyer (or the buyer's agent) uses the documents to claim the goods.
11. A draft, which accompanies the letter of credit, is paid by the buyer's bank at the time specified or, if a time draft, may be discounted to the exporter's bank at an earlier date.

If the exporter believes the political and commercial risks are not sufficient to require a letter of credit, the exporter may agree to payment on a *documentary draft basis*, which is less costly to the buyer. An **export draft** is an unconditional order drawn by the seller on the buyer instructing the buyer to pay the amount of the order on presentation (*sight draft*) or at an agreed future date (*time draft*). Generally, the seller will ask its bank to send the draft and documents to a bank in the buyer's country, which will proceed with the collection as described in the letter-of-credit transaction.

Although documentary draft and letter-of-credit terms are similar, there is one important difference. A confirmed letter of credit guarantees payment to the seller if the seller conforms to its requirements. There is no guarantee with a documentary draft. An unscrupulous buyer can refuse to pay the draft when presented and then attempt to bargain with the seller for a lower price. The seller must then acquiesce, try to find another buyer, pay a large freight bill to bring back the goods, or abandon them. If the seller chooses the last alternative, customs will auction off the goods, and chances are that the original buyer will be able to acquire them at a bargain price. The seller would receive nothing. Figure 14.4 illustrates that the risks and costs vary inversely among the various export payment terms.

export draft

An unconditional order drawn by the seller that instructs the buyer to pay the draft's amount on presentation (*sight draft*) or at an agreed future date (*time draft*) and that must be paid before the buyer receives shipping documents

LO14-3 Identify some sources of export financing.

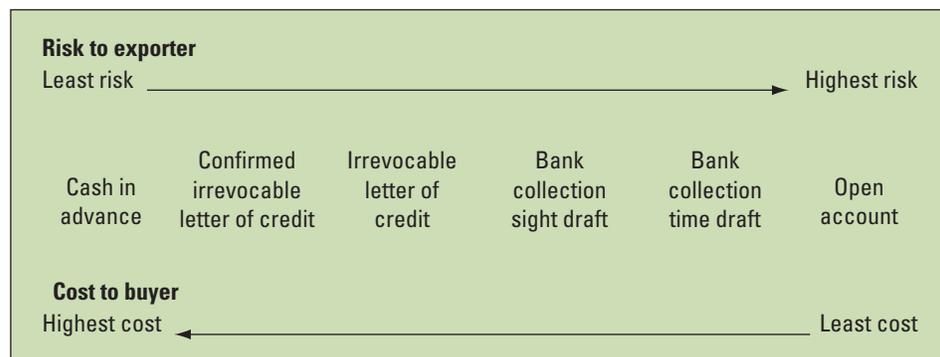
EXPORT FINANCING

Although exporters would prefer to sell on the almost riskless letter-of-credit terms, increased foreign competition and the universally tight money situation force them to offer credit. To do so, they must be familiar with the available sources and kinds of export financing, both private and public.

Private Source Commercial banks have always been a source of export financing through loans for working capital and the discounting of time drafts. A bank may discount an export time draft, pay the seller and keep it until maturity or, if it is the bank on which

FIGURE 14.4

Payment Risk/Cost Trade-Off



Source: *Business America* (U.S. Department of Commerce Publication), February 1995.

the draft is drawn, “accept” it. By accepting a time draft, a bank assumes the responsibility for making payment at maturity of the draft. The accepting bank may or may not purchase (at a discount) the draft. If it does not, the exporter can sell a **banker’s acceptance** readily in the open market.

In recent years, two new types of financing have been developed, factoring and forfaiting. **Factoring** permits the exporter to be more competitive by selling on open account rather than by means of the more costly letter-of-credit method. This financing technique is the sale of export accounts receivable to a third party, which assumes the credit risk. Factoring is essentially discounting without recourse. A factor may be a factoring house or a special department in a commercial bank. Under the export factoring arrangement, the seller passes its order to the factor for approval of the credit risk. Once the order has been approved, the exporter has complete protection against bad debts and political risk. The customer pays the factor, which in effect acts as the exporter’s credit and collection department. The period of settlement generally does not exceed 180 days.

Forfaiting is the purchase of obligations that arise from the sale of goods and services that fall due at some date beyond the 90 to 180 days that is customary for factoring. These receivables are usually in the form of trade drafts or promissory notes with maturities ranging from six months to five years. Because forfeited debt is sold without recourse, it is nearly always accompanied by bank security in the form of a guarantee, or *aval*. Whereas the guarantee is a separate document, the *aval* is a promise to pay that is written directly in the document. The forfaiter purchases the bill and discounts it for the entire credit period. Thus, the exporter, through forfaiting, has converted its credit-based sale into a cash transaction. Although banks have traditionally concentrated on short-term financing, they have become involved in medium- and even long-term financing because numerous government and government-assisted organizations are offering export credit guarantees and insurance against commercial and political risks.

Public Source The **U.S. Export-Import Bank (Ex-Im Bank)** is the principal government agency responsible for aiding the financing of American exports, through a variety of loan, guarantee, and insurance programs. Ex-Im Bank’s programs are available to any American export firm regardless of size. The bank provides two types of loans—direct loans to foreign buyers of American exports and intermediary loans to responsible parties, such as a foreign government lending agency that relends to foreign buyers of capital goods and related services. An example of the latter is a maintenance contract for a jet passenger plane. Both programs cover up to 85 percent of the value of the exported goods and services, with repayment terms of one year or more.

Ex-Im Bank’s *Working Capital Guarantee* helps small businesses obtain working capital to cover their export sales. It guarantees working capital loans extended by banks to eligible exporters with exportable inventory or export receivables as collateral. The guarantee provides repayment protection for private sector loans to buyers of U.S. capital equipment and related services.

Ex-Im Bank also offers *export credit insurance*. An exporter may reduce financing risks by purchasing insurance to protect against the political and commercial risks of a foreign buyer’s defaulting on payment. The coverage may be comprehensive or be limited to political risk only. Since its inception in 1934, Ex-Im Bank has supported more than \$456 billion in American exports, mostly to developing markets.⁶

Other Public Incentives Other government incentives for trade, although not strictly a part of export financing, are so closely related to it that we mention them here. These are the Overseas Private Investment Corporation and the foreign trade zone.⁷

The **Overseas Private Investment Corporation (OPIC)** is a government corporation formed to stimulate private investment in developing countries. It offers investors insurance against expropriation, currency inconvertibility, and damages from wars or revolutions. OPIC also offers specialized insurance for American service contractors and exporters operating in foreign countries. Exports of capital equipment and semiprocessed raw materials generally follow these investments.

banker’s acceptance

A time draft with maturity of less than 270 days that has been accepted by the bank on which the draft was drawn, thus becoming the accepting bank’s obligation; may be bought and sold at a discount in the financial markets like other commercial paper

factoring

Discounting without recourse an account receivable

forfaiting

Purchasing without recourse an account receivable whose credit terms are longer than the 90 to 180 days usual in factoring; unlike factoring, political and transfer risks are borne by the forfaiter

U.S. Export-Import Bank (Ex-Im Bank)

Principal government agency that aids American exporters by means of loans, guarantees, and insurance programs

Overseas Private Investment Corporation (OPIC)

Government corporation that offers American investors in developing countries insurance against expropriation, currency inconvertibility, and damages from wars and revolutions

foreign trade zone (FTZ)

Duty-free area designed to facilitate trade by reducing the effect of customs restrictions

free trade zone (FTZ)

An area designated by the government as outside its customs territory

customs drawbacks

Rebates on customs duties

Foreign trade zones (FTZs) are duty-free areas designed to facilitate trade by reducing the effect of customs restrictions. These areas may be free ports, transit zones, free perimeters, export processing zones, or free trade zones. In each instance, a specific and limited area is involved, into which imported goods may be brought without the payment of import duties. There are hundreds of these areas in more than 28 countries. Of the five types, the free trade zone is the most common.

The **free trade zone (FTZ)** is an enclosed area considered to be outside the customs territory of the country in which it is located. Goods of foreign origin may be brought into the zone for eventual transshipment, reexportation, or importation into the country. While the goods are in the zone, no import duties need be paid. Examples range from the Zhuhai Free Trade Zone, near Macao in China, to Chabahar in Iran. In the United States, free trade zones often are called foreign trade zones (and the FTZ acronym is used synonymously for both in the United States). They have been growing in popularity, and 250 of these zones, with more than 450 subzones, are now in operation.⁸ Many are situated at seaports, but some are located at inland distribution points. Goods brought into the FTZ may be stored, inspected, repackaged, or combined with American components. Because of differences in the import tariff schedule, the finished product often incurs lower duty than would the disassembled parts. Bicycles have been assembled in the Kansas City FTZ for that reason. Importers of machinery and automobiles improve their cash flow by storing spare parts in an FTZ, because duty is not paid until they are withdrawn.

In addition to their advantages to importers, FTZs can also benefit exporters. By using FTZs, exporters may be eligible for accelerated export status in regard to excise tax rebates and **customs drawbacks**. These customs duty rebates are available for items such as tires, trucks, and tobacco products. The federal government collects the tax when the item is manufactured; when it is exported, the tax is rebated. The processing time for tax rebates can be initiated by putting the goods into FTZs because a product is considered exported as soon as it enters the FTZ. Although U.S. Customs has had the duty-drawback program in place for 200 years, many firms do not claim the money they're owed. As a result, each year up to \$2 billion in customs duty refunds goes unclaimed.⁹ FTZs offer another benefit to exporters: when manufacturing or assembly is done in FTZs using imported components, no duties need ever be paid when the finished product is exported.

L014-4 Describe

the activities of a foreign freight forwarder.

Export Procedures

When those new to exporting are concerned about the complexity of export procedures, they are generally referring to documentation. Instead of dealing with the two documents used in domestic shipments, the freight bill and the bill of lading, export novices are suddenly confronted with five to six times as many documents, depending on the country. Table 14.1 summarizes documentation requirements for major locations and the United States.

"Exports move on a sea of documents" is a popular saying in the industry, and it seems an accurate description. Many firms give at least part of this work to a *foreign freight forwarder*, who acts as an agent for the exporter. Foreign freight forwarders prepare documents, book space with a carrier, and in general act as the firm's export traffic department. If asked, they will offer advice about markets, import and export regulations, the best mode of transport, and export packing. They also will supply cargo insurance. After shipment, they forward documents to the importer or to the paying bank, according to the exporter's requirements. We look now at the two basic elements of exporting, the paperwork and the actual transportation of goods. Then, in the next section, we look at import procedures, often the mirror image of export procedures.

L014-5 Outline

the export documents required.

EXPORT DOCUMENTS

Correct documentation is vital to the success of any export shipment. Interestingly enough, error rates reported for export and import documentation hover between 50 and 70 percent, largely because they are documents that come from different parties, yet their data need to be consistent.¹⁰ Think of the impact of that statistic—goods waiting in a container, on a dock, or in a warehouse, tying up working capital. We'll review the two sets of documents required to ship and collect goods.

TABLE 14.1 Time, Cost, and Documents to Export and Import by Ocean Transport

Region or Economy	Documents for Export (number)	Time for Export (days)	Cost to Export (US\$ per container)	Documents for Import (number)	Time for Import (days)	Cost to Import (US\$ per Container)
East Asia and Pacific	6.4	22.7	889.8	6.9	24.1	934.7
Eastern Europe and Central Asia	6.4	26.7	1,651.7	7.6	28.1	1,845.4
Latin America and Caribbean	6.6	18.0	1,228.3	7.1	20.1	1,487.9
Middle East and North Africa	6.4	20.4	1,048.9	7.5	24.2	1,229.3
OECD	4.4	10.9	1,058.7	4.9	11.4	1,106.3
South Asia	8.5	32.3	1,511.6	9.0	32.5	1,744.5
Sub-Saharan Africa	7.7	32.3	1,961.5	8.7	38.2	2,491.8
United States	4.0	6.0	1,050	5	5	1,315

Source: World Bank, International Finance Corporation, www.doingbusiness.org/data/exploretopics/trading-across-borders (June 16, 2011).

Shipping Documents Shipping documents are prepared by exporters or their freight forwarders so that the shipment can pass through U.S. Customs, be loaded on the carrier, and be sent to its destination. They include the domestic bill of lading, the export packing list, the shipper’s export declaration, the export licenses, the export bill of lading, and the insurance certificate. The first two documents are nearly the same as those used in domestic traffic, so we’ll focus here on the other four.

The **shipper’s export declaration (SED)** is required by the Department of Commerce to control exports and supply export statistics. An SED contains:

1. Names and addresses of the shipper and consignee.
2. U.S. port of exit and foreign port of unloading.
3. Description and value of the goods.
4. Export license number and bill-of-lading number.
5. Name of the carrier transporting the merchandise.

Shippers or their agents (foreign freight forwarders) deliver the SED to the carrier, which turns it in to U.S. Customs with the carrier’s manifest (list of the vessel’s cargo) before the carrier leaves the United States. An **automated export system (AES)** with electronic filing was introduced in 2004. Because many errors can be flagged in the system, data entry on the forms has been greatly reduced and export processing has been sped up.

An *export license* from the U.S. federal government is required for all exported goods except those going to U.S. possessions or, with a few exceptions, to Canada. These licenses are either validated or general. A **validated export license** is required for strategic materials and all shipments to unfriendly countries. This is a special authorization for a specific shipment and is issued by the Department of Commerce Office of Export Administration. It is required for scarce materials, strategic goods, and technology. The Department of State issues the validated license for war materials. A **general export license** is used for all products that do not require the validated license.

An **export bill of lading (B/L)** serves three purposes: it functions as a contract for carriage between the shipper and the carrier, a receipt from the carrier for the goods shipped, and a certificate of ownership. B/Ls are either *straight* or *to order*. A straight bill of lading is nonnegotiable. Only the person stipulated in it may obtain the merchandise on arrival. An order bill of lading, however, is negotiable. It can be endorsed like a check or left blank. With an order B/L, the holder is the owner of the merchandise.

The *insurance certificate* is evidence that the shipment is insured against loss or damage while in transit. Unlike domestic carriers, oceangoing steamship companies assume no

shipper’s export declaration (SED)

U.S. Department of Commerce form used to control export shipments and record export statistics

automated export system (AES)

U.S. Customs electronic filing system

validated export license

A required document issued by the U.S. government authorizing the export of a strategic commodity or a shipment to an unfriendly country

general export license

Any export license covering export commodities for which a validated license is not required; no formal application is required

export bill of lading (B/L)

Contract of carriage between shipper and carrier: straight bill of lading is non-negotiable; endorsed “to order” bill gives the holder claim on merchandise

responsibility for the merchandise they carry unless the loss is caused by their negligence. Marine insurance may be arranged by either the exporter or the importer, depending on the terms of sale. The laws of some countries may require that the importer buy such insurance, thus protecting the local insurance industry and saving foreign exchange. If the exporter has sold on sight draft terms, the firm carries the risk while the goods are in transit. In this case, the exporter should buy contingent interest insurance to protect it in the event that the shipment is lost or damaged and collection from the buyer is not successful. We believe that the exporter selling on CFR terms (the buyer purchases the insurance) should also buy contingent interest insurance to protect itself in case the buyer’s insurance does not cover all risks.

There are three kinds of marine insurance policies: basic named perils, broad named perils, and all risks. *Basic named perils* include perils of the sea, fires, jettisons, explosions, and hurricanes. *Broad named perils* include theft, pilferage, nondelivery, breakage, and leakage in addition to the basic perils. *All risks* covers all physical loss or damage from any external cause and is more expensive than the other policies. War risks are covered under a separate contract. Premiums depend on a number of factors, such as the goods insured, the destination, the age of the ship, whether the goods are stowed on deck or under deck, the volume of business, how the goods are packed, and the number of claims the shipper has filed. Brokers will sometimes admit that in the long run, it is preferable not to file numerous small claims, even if justified, because the higher premiums charged for future shipments will be greater than the money recovered.

Collection Documents The seller is required to provide the buyer with collection documents to receive payment. These documents vary among countries and customers, but some of the most common are invoices, both commercial and consular, certificates of origin, and inspection certificates.

Export invoices are similar to domestic invoices. The commercial invoice includes additional information, such as the origin of the goods, export packing marks, and a clause stating that the goods will not be transshipped to another country. Invoices for letter-of-credit sales name the bank and the credit numbers. Some importing countries require that the commercial invoice be in their language and be visaed or endorsed by their local consul. The *consular invoice* is a special form purchased from the consul, prepared in the language of the country, and then visaed by the consul. Along with the export invoice, many governments require a *certificate of origin*, which is usually issued by the local chamber of commerce and visaed by the consul.

An *inspection certificate* is required frequently by buyers of grain, foodstuffs, and live animals. In the United States, inspection certificates are issued by the Department of Agriculture. Purchasers of machinery or products containing a specified combination of ingredients may insist that an American engineering firm or laboratory inspect the merchandise and certify that it is exactly as ordered. The EU requires the **CE (Conformité Européene) mark** is the European “trade passport”: once a product has the mark, it can travel to any other EU member country without modification. This mark indicates that the merchandise conforms to European health, safety, and environmental requirements.¹¹ The certification process has been streamlined, and most merchandisers can self-certify that their merchandise conforms to EU regulations. Inspection by authorized testing houses is required of hazardous goods.

CE (Conformité Européene) mark

EU mark that indicates that the merchandise conforms to European health, safety and environmental requirements

EXPORT SHIPMENTS

Most newcomers to exporting are so focused on making their sale and handling the documentation that they fail to be concerned about the actual physical movement of their goods. Innovations in material-handling techniques can help exporters reduce costs and perhaps reach markets they previously could not serve. Containerization, LASH, RO-RO, size, and air freight all offer increasingly cheaper, faster, and safer transportation solutions, shrinking our globe.

One means of drastically reducing both theft and handling costs is to use containers. *Containers* are large boxes—8 feet by 8 feet by 10, 20, or 40 feet—that the seller fills with the shipment in the firm’s warehouse. Their origins are interesting, as explained in the



The Ethics of Exporting: Do Home Values Apply?

In early 2011, Australia banned the export of Australian cattle to Indonesia after reliable reports of cruelty in Indonesian slaughterhouses came to the attention of the Queensland government. At first glance, this action sounds like a responsible commitment to the humane treatment of animals.

Yet there is a dilemma or two here because there are beef ranchers in Queensland who depend totally on the live export market for their sales. And Indonesia is a huge market for them. One-third of the meat eaten in Indonesia is Australian beef.

In addition, as a result of the ban, there is less food for the 40 million Indonesians who live below the poverty line. "Ah, but they probably don't eat imported beef," you may be thinking. That's true, but when there's less food in the system, the poor will feel the effects first.

Other ethical issues related to exporting also touch on whether the home-country ethics should be upheld for the exports. Should the United Kingdom, which has outlawed the death penalty, export execution drugs to the United States? Should quality standards thought appropriate for the domestic market be maintained for the export markets in areas such as pharmaceuticals?

These issues about the ethics of exporting are the question here. To what degree are ethics domestic and to what degree are they universal? Another way to phrase the question is, Should exports have ethics embedded in them? What do you think?

Sources: *Ethics Newline*, www.globoethics.org/newsline/2011/06/13/australia-cattle/, June 13, 2011 (accessed June 20, 2011); "British Company Exports Execution Drugs to U.S.," www.ethicsdaily.com/british-company-exports-execution-drugs-to-us-cms-17498 (accessed June 20, 2011).

chapter's opening story. Once packed, the containers are then sealed; they are opened when the goods arrive at their final destination. Containers are transported by truck or rail from the warehouse to shipside for loading. From the port of entry, railroads or trucks deliver them, often unopened even for customs inspection, to the buyer's warehouse. In most countries, customs officials go to the warehouse to examine the shipment. This integrated process reduces handling time and the risk of damage and theft because the buyer's own employees unload the containers.

If the importer or exporter has a warehouse on a river too shallow for ocean vessels, the firm can save time and expense by loading containers on barges. *LASH* (lighter aboard ship) vessels provide direct access to ocean freight service for exporters and importers located on shallow inland waterways. Sixty-foot-long barges ("lighters") are towed to inland locations, loaded, and towed back to deep water, where they are loaded aboard anchored *LASH* ships.

Another innovation in cargo handling is *RO-RO* (roll on–roll off) ships. Loaded trailers and any equipment on wheels can be driven onto these specially designed vessels. *RO-RO* service has brought the benefits of containerization to ports that have been unable to invest in the expensive lifting equipment required for containers.

Ship size continues to expand. Until recently, the standard largest size was "Panamax," which fit through the Panama Canal's locks with only feet to spare. "Post-Panamax" ("Suezmax," "capesize") ships are too big for the canal—nearly 44 feet too wide and more than 200 feet longer than the canal can accept. Some 160 of these ships will be put in operation over the next few years, many to carry Chinese exports. So, Panama must build a third set of even larger locks: work began in 2007 and may be completed by 2015.

Air freight has had a profound effect on international business because it permits shipments that once required 30 days to arrive in 1 day. Huge freight planes carry payloads of 200,000 pounds, most of which goes either in containers or on pallets. Airlines guarantee overnight delivery from New York to many European airports and claim that their planes can be loaded or unloaded in 45 minutes.

Newcomers to exporting might assume that ocean freight is a better choice than air freight because ocean freight is so much cheaper. Comparison of total costs of each mode may suggest otherwise. Total cost components that may be lower for air freight include insurance rates, because of much less chance of damage during shipment; packing costs, because the shipment does not need the heavier, more costly export packing, which is usually done by an outside firm; customs duties, when calculated on gross weights; replacement

TABLE 14.2 Sea-Air Total Cost Comparison, Shipment of Spare Parts

	Ocean Freight (with warehousing)	Air Freight (no warehousing)
Warehouse administrative costs	\$1,020	—
Warehouse rent	1,680	—
Inventory costs		
Taxes and insurance	756	\$ 396
Inventory financing	288	192
Inventory obsolescence	1,800	0
Seller's warehouse and handling costs	1,810	1,140
Transportation	420	2,400
Packaging and handling	300	120
Cargo insurance	72	36
Customs duties	132	127
Total	\$8,278	\$4,411

costs for damaged goods, again because of the reduced damage risk; and inventory costs, because the rapid delivery by air freight often eliminates the need for expensive warehouses. For example, Mercedes-Benz includes in the price of its luxury sports car Brabus SLR McLaren air freight from Bottrop, Germany, to anywhere in the world. Another cost saving is that machinery shipped by air does not require a heavy coat of grease to protect it from the elements, as does machinery sent by ship. Table 14.2 provides a sample comparison of the cost elements of ocean and air freight.

Even when the total shipping costs are higher for air freight, shipping by air may still be advantageous for several reasons:

1. *Total cost may decrease.* Getting the product to the buyer more quickly results in a more satisfied customer and faster payment, which speeds up the return on investment and improves cash flow. The firm's capital is released more quickly and can be invested in other profit-making ventures or used to repay borrowed capital, thus reducing interest payments. Production equipment may be assembled and sent by air so that it goes into production sooner, without the transit and setup delays associated with ocean shipments, a strong sales argument. These production and opportunity costs, although difficult to calculate, are part of the total cost.
2. *Either the firm or the product may be air-dependent.* Perishable food products being shipped to Europe, Japan, and the Middle East are in this category, as are live animals (newly hatched poultry and prize bulls) and fresh flowers. Without air freight, firms exporting such products would be out of business.
3. *The market may be perishable.* For goods with short life cycles, such as high-fashion products, delivery speed matters. When a fashion fad dies, its market goes with it.
4. *Competitive position may be strengthened.* The sales argument that spare parts and factory technical personnel are available within a few hours is a strong one for an exporting firm competing with overseas manufacturers.

Importing

In one sense, importers are the reverse of exporters: they sell domestically and buy in foreign markets. However, many of their concerns are similar. As in the case of exporters, there are small firms whose only business is to import, and there are global corporations for which importing components and raw materials valued at millions of dollars is just one of their functions. We will examine sources for imports, the role of customhouse brokers, and the payment of import duties here.

L014-6 Identify
import sources.

SOURCES FOR IMPORTS

Before importing, a firm may have difficulty determining whether the desired items exist and, if so, where to find them. How does the prospective importer identify import sources? There are a number of ways. First, similar imported products may already be in the market. By simple close examination, you can learn where they are made and often by whom. U.S. law requires that the country of origin be clearly marked on each product or on its container if product marking is not feasible (e.g., individual cigarettes). The consul or embassy of the country of origin can help with names of manufacturers. One of the principal duties of all foreign government representatives is to promote exports, and they do this through newsletters, trade shows, industry shows, and collaborative events with their home country chamber of commerce group and other organizations, such as, for Japan, the Japan External Trade Organization (JETRO), which has a number of offices outside Japan. The process is the same if the product is not being imported. You simply have less information with which to begin.

Other sources of information are electronic bulletin boards such as those of the World Trade Centers. Accidental importing also occurs with some frequency. When you visit a foreign country, look for products that may have a market at home. Finding one could put you into a new business, one that makes foreign travel tax-deductible.

Now we turn to some of the technical aspects of importing, customhouse brokers, and import duties.

CUSTOMHOUSE BROKERS

In every nation, there are **customhouse brokers**, whose functions parallel those of foreign freight forwarders but are on the import side of the transaction. As the agent for the importer, the customhouse broker brings the imported goods through customs, which requires that they know well the many import regulations and an extensive, complex tariff schedule. If a customs official places the import in a category requiring higher import duties than the importer had planned on, the importing firm may not be able to compete. To levy customs, evaluators everywhere generally use units shipped for products that carry specific duties and the invoice price for ad valorem duties. There are some exceptions. The practice of U.S. Customs is to use the transaction price, which appears on the commercial invoice accompanying the shipment, plus any other charges not included in the transaction price. These may be royalty or license fees, packing, or any assists. *Assist* is the U.S. Customs term applied to any item that the buyer provides free or at reduced cost for use in the production or sale of merchandise for export to the United States. Examples are molds and dies sent overseas to produce a specific product, a common practice of importers who want the goods produced using their design, and components and parts that the buyer provides for incorporation in the finished article.

Customhouse brokers also provide other services, such as arranging transportation for the goods after they have left customs if the exporter has not arranged for it. They also keep track of which imports are subject to import quotas and how much of the quota has been filled at the time of the import. No matter which port the goods arrive at, U.S. Customs knows immediately the quantity that has been imported. Merchandise subject to import quotas can be on the dock of an American port awaiting clearance through customs, but if the quota fills anywhere during the wait, those goods cannot be imported for the rest of the fiscal year. The would-be importer can put them in a **bonded warehouse** or a foreign trade zone, where merchandise can be stored without paying duty, and wait for the rest of the year; abandon them; or send them to another country. Importers of high-fashion clothing have lost millions of dollars when quotas became filled and they had a shipment that had not yet cleared. They could not sell the clothing until the following year, by which time it was out of fashion.

IMPORT DUTIES

Every importer should know how U.S. Customs calculates import duties and the importance of the product classification system, the **Harmonized Tariff Schedule of the United States (HTSA or HTSUS)**, the American version of the global tariff code, the Harmonized

customhouse brokers

Independent businesses that handle import shipments for compensation

bonded warehouse

An area authorized by customs authorities for storage of goods on which payment of import duties is deferred until the goods are removed

Harmonized Tariff Schedule of the United States (HTSA or HTSUS)

American version of the Harmonized System used worldwide to classify imported products



Head of U.S. Export-Import Bank Calls Foul on China, India, and Brazil; Changes Game Rules



Ex-Im President Fed Hochberg recently pointed out that Brazil, India, and China provide export funding, particularly export credit, at levels that violate the export finance rules that bind the G7 and OECD countries. Together, Brazil, China, and India presently provide more export funding than do the combined nations of the G7 (the United States, Japan, France, Germany, Britain, Canada, and Italy).

This aid extended to foreign customers translates into more sales. Chinese telecoms manufacturer Huawei Technologies

has experienced impressive market share growth that is based, Hochberg suggests, on a \$30 billion credit line from the Chinese Development Bank that allowed it to offer its customers far better financing terms than could its developed nation competitors. "In less than 15 years, they have positioned themselves ahead of global leaders like Nokia and Siemens. In India, Huawei grew to \$2.5 billion in sales from \$50 million in one year," Hochberg said. "Folks, that kind of growth takes more than just good sales and marketing strategies."

Such Chinese "state-directed capital" threatens U.S. market share in renewable energy, aviation, biotechnology, and capital goods.

Currently, GE has been underbid by China on a lucrative 500-locomotive contract in Pakistan. China offered financing and credit terms that GE could not meet and stay within G7 and OECD rules. Hochberg's response to GE's complaint is to call for a change in the G7 rules so that when there is market distortion caused by state-directed capital, G7 members can respond with competitive support for developed nations' firms. Ex-Im Bank will help GE make this sale, Hochberg vows. Eventually, he thinks, the developing countries will have to renegotiate rules on export financing so that their unfair subsidies don't distort trade.^a Under his leadership in 2010, his first full year on the job, Ex-Im Bank approved \$24.5 billion in export financing, a 70 percent increase over the past two years. It sounds like he means business.

Questions:

1. There is an argument that developing countries ought to be able to maintain their subsidies, the ones to which Hochberg objects, because these countries need advantages to break into and become established in world markets. Do you agree?
2. Should a U.S. taxpayer-supported agency such as the Ex-Im Bank act internationally on behalf of American companies such as GE to support their export sales?

^a"U.S. Must Confront China Export Advantages," *Reuters*, June 15, 2011, www.reuters.com/article/2011/06/15/us-usa-china-financing-idUSTRE75E6B820110615 (accessed June 17, 2011).

System. The Harmonized System is a classification system for the more than 200,000 commodities traded internationally, and it includes interpretive notes that help determine the classifications.

In HTSA each product has its own unique number. All member-countries use the same system, so it is possible to describe the product in any language by using the first six digits. The other four digits are for use just in the United States. The HTSA also shows the *reporting units*, which U.S. Customs uses in its paperwork. The last three columns have to do with the rate of duty. Rates of duty are broken down into three levels for each item—general, special, and a third-rate level for countries not considered friends of the United States. The HTSA is accessible on the Internet.¹²

New importers would do well to follow this advice: disclose fully to the U.S. Customs Service all foreign and financial arrangements before passing the goods through U.S. Customs. The penalties for fraud are high. Get the advice of a customhouse broker *before* making the transaction. Frequently, a simple change in the product description can result in a much lower import duty. For example, jeans carry higher duties if the label is outside the back pocket instead of under the belt. If the words on the label are stylized, the duties are higher as well. Any clothing that is ornamented has higher duty. One importer brings in plain sports shirts and then sews on an animal figure after the products are in the United States. One last word of advice: calculate carefully the landed price in advance. If you are unsure of the import category, ask U.S. Customs to determine the category in advance and to put it in writing, just like advanced rulings from the Internal Revenue Service. At the time of importation, customs inspectors must respect this determination.



Vadim Rozhkov: International All the Way!



I was born in Ekaterinburg, Russia. I enjoy active sports, surfing, rally, boxing, and hiking. My hobbies include history, travel, applied science, and listening to classical music. I have a BS degree in mechanical engineering from Ural State University in Russia;

I then earned a BS in electrical engineering, MS in industrial technology, and MBA from California Polytechnic State University in San Luis Obispo.

My interest in international business came up a bit unexpectedly, a result of my interest in global heavy industries and their involvement in international trade and politics. Studying for my MBA gave me a better understanding of global trade, including knowledge about the economic aspects of manufacturing and production, price formation, and cross-border tariffs.

I am a sales manager, involved directly in business-to-business sales. Sales managers at my company are given different countries of responsibility, and my assigned countries include Italy, Germany, and Mexico.

My job is to identify and contact a circle of potential customers—namely, companies that purchase tooling for operating large-scale metallurgical mills. I use an information-based approach to identifying customers. First, I trace metals prices on the LME (London Metal Exchange), and I usually have a good idea of the average price for my product in my assigned countries. Then I contact and visit representatives from these companies' technical maintenance, engineering, and purchasing departments. After the initial meeting, where I am given drawings and specifications of the product they are interested in, I work with my company's accounting department to calculate manufacturing costs, and I determine logistics and insurance expenses (I am in constant contact with different shipping companies). It usually takes a few days to come up with a final quote for the product and a delivery option. Most of my customers request CIF Incoterms, which means my company as the seller pays the cost, insurance, and freight associated with shipping goods to the destination port. Then this quote is sent to my customer. If my customer accepts the price and delivery options, a purchasing/manufacturing contract is signed.

I visit a potential customer only when I am sure that I am well prepared for the trip, that the customer is expecting me, and that the topic of the visit is clearly laid out and ready for discussion. I usually have phone conversations in advance with the people I intend to meet during my visit. Not only do I know the financial aspect of a possible deal, I also come very well prepared technically. I study the products my customers use. I know how my products are installed and operated within complex, large-scale metallurgical mills. It is very important that my customers see that I have deep technical understanding of the products I am selling. I also study my competitors. I know the strong and weak points of their products, and I am knowledgeable about their business policies.

The biggest challenge of my job is coming to agreement with my international customers on common terms for the purchase. Cultural differences play a big role in dealing with people overseas and understanding the ways that people conduct their business in a particular country is crucially important. For example, as a result of my numerous business trips to Mexico, I have learned to respect the local pace of life. Sometimes rushing things will not necessarily make things happen more quickly!

The greatest enjoyment of my job, so far, was signing my first contract for supplying tooling to a company in Mexico. Actually, I was ecstatic, because it took me two years of work and relationship-building effort before this contract finally came through.

Doing business internationally teaches you a few great things. Patience is one of them. After all, you are a guest and a foreign business representative. Simply put, you are asking for a part of their business and you need them more than they need you.

In my opinion, to be successful in international business, you need common sense, cultural respect, and extensive knowledge of the subject or business area in which you are working. As for what *not* to do: never leave your customer aggravated, despite how ridiculous their suggestions or demands may seem. Even if you don't sign a deal today, make sure you will be able to come back tomorrow and have a friendly conversation with your potential customer.

Resources for Your Global Career

Consider a Job in Import/Export Management for Entry into International Business

With the growing volume of shipments between countries daily, there is demand for people to work in entry-level positions in import/export management. Managing the movement of products into and out of countries is a fundamental task in international trade, and job opportunities exist in every type of business dealing with foreign customers or suppliers and in size ranging from small businesses to *Fortune* 500 companies. To succeed in import/export management, you will need to know about the fundamentals of business; customer service; international business considerations; purchasing; marketing; import/export operations; and documentation for licenses, bills of lading, insurance, domestic and foreign country customs laws, and international trade regulations for the countries in which the importer/exporter is dealing. Language skills would be valuable. Entry-level salaries are in the range of \$31,000 to \$42,000, mid-level salaries are between \$46,000 and \$64,000, and top-level import/export manager salaries are between \$69,000 and \$96,000+ based on experience. Import/export management jobs can be found in or at the following:

- Import/export houses.
- International trading companies.
- Manufacturers of all sizes trading internationally.
- Wholesalers importing or exporting products.
- The corporate level for retail chains.

(continued)

- Purchasing departments for international companies.
- Customhouse brokers.
- Freight forwarders.
- Supply chain management organizations.
- Airlines and ocean shipping firms.

To advance your career and move into higher levels of import/export management, with greater responsibility, salary, and job mobility, you may want to earn the U.S. Customs Broker License:

www.cbp.gov/xp/cgov/trade/trade_programs/broker/brokers.xml
www.ncbfaa.org/About/content.cfm?ItemNumber=2302

Your Worldwide Resources on Import/Export Operations:

- In-depth information on import/export marketing: www.export911.com/
- Glossary of trade terms, shipping terms, ex-im terms, and trade laws: www.fibre2fashion.com/textterms/exim/exim_terms1.htm
- Your import/export library: www.the-acr.com/ie/library.htm
- Guide to starting your own import/export business: <http://importexportcoach.com>
- U.S. government import/export resources: <http://export.gov>
- International Trade Administration: <http://trade.gov/index.asp>
- U.S. Export Administration: www.access.gpo.gov/bis/
- U.S. Government Export Portal: www.export.gov/
- Bureau of Industry and Security: www.bis.doc.gov/exportlicensingganda.htm
- Export Information Database: www.access.gpo.gov/bis/ear/ear_data.html
- Department of Commerce Export Controls: www.bis.doc.gov/licensing/exportingbasics.htm
- Resources for planning for import/export operations:
 - <http://sbinfocanada.about.com/od/canadaexport/a/10exportsteps.htm>
 - <http://sbinfocanada.about.com/cs/marketing/a/export-markplan.htm>
 - www.canadabusiness.ca/eng/105/
- Exporting information from Austrade, the Australian government's Office of Export Management and Assistance (see the checklist): www.austrade.gov.au/Getting-ready-for-export/default.asp
- Export compliance issues:
 - www.ytsbest.com/EXPORT-ADMINISTRATION-REGULATIONS-%28EAR%29-CLASSIFICATION-PROCESS-.html
 - www.exportcompliance.com/import-controls.html
 - www.exportcompliance.com/export-controls.html
 - www.exportcompliance.com/landed-cost-calculator.html
- Export articles, data and statistics: www.wisertrade.org/home/index.jsp?content=/news.jsp

Summary

L014-1 Identify the sources of export counseling and support.

The Trade Information Center, Small Business Administration, Small Business Development Centers, Department of Agriculture, state offices for export assistance, and World Trade Centers Association are some sources of export counseling. The Department of Commerce, the federal department in charge of export assistance, offers many programs covering all aspects of exporting. Commerce also assists in locating foreign representatives and making sales through trade fairs, matchmaker programs, and catalog and video shows.

L014-2 Discuss the meaning of the various terms of sale known as Incoterms.

There are 11 Incoterms used to describe the terms of sale in import/export transactions. Seven apply to general transportation, and four are reserved for water transportation. The general transportation terms are Ex-Works (named place), where

the seller makes goods available at factory or warehouse; FCA (named place), free carrier, where the seller hands over goods to carrier at a named place; CPT (named destination), where carriage is paid to destination, while risk passes when goods are handed to carrier; CIP (named place of destination), where carriage and insurance are paid to destination, while risk passes when goods are handed to carrier; DAT, where goods are delivered at terminal and seller pays for transport and insurance to terminal and has risk until goods loaded at terminal; DAP, where goods are delivered at place (name of destination) and the seller pays for carriage to the named place and assumes all risk until goods are unloaded; and DDP (destination place), where goods are delivered to destination and covers all duties, taxes, customs. The water transport terms include FAS (named loading port), where the goods are free alongside ship and the seller clears the goods for export and places them by the ship; FOB (named loading port), where the goods are free on board and the seller loads goods, with

risk passing at rail; CFR (named destination port), where cost and freight is covered by seller and risk passes once goods are loaded; and, finally, CIF (named destination port), which is the same as CFR, but includes insurance. Risk still passes at ship's rail.

L014-3 Identify some sources of export financing.

Some sources of export financing are commercial banks, factors, forfaiting, the Export-Import Bank (Ex-Im Bank), and the Small Business Administration.

L014-4 Describe the activities of a foreign freight forwarder.

Foreign freight forwarders act as agents for exporters. They prepare documents, book space on carriers, and function as a firm's export traffic department.

L014-5 Outline the export documents required.

Correct documentation is vital to the success of any export shipment. Shipping documents include export packing lists, export licenses, export bills of lading, shipper's export declaration, and insurance certificates. Collection documents include commercial invoices, consular invoices, certificates of origin, and inspection certificates.

L014-6 Identify import sources.

Prospective importers can identify sources in a number of ways. They can examine the product label to see where the product is made and then contact the nearest embassy of that country to request the name of the manufacturer. Foreign chambers of commerce and trade organizations provide information on their countries' exporters. Electronic bulletin boards and data banks are also useful.

Key Words

terms of sale (p. 345)

Incoterms (p. 345)

letter of credit (L/C) (p. 346)

confirmed L/C (p. 347)

irrevocable L/C (p. 347)

air waybill (p. 347)

pro forma invoice (p. 347)

export, sight, and time drafts (p. 350)

banker's acceptance (p. 351)

factoring (p. 351)

forfaiting (p. 351)

U.S. Export-Import Bank (Ex-Im Bank) (p. 351)

Overseas Private Investment Corporation (OPIC) (p. 351)

foreign trade zone (FTZ) (p. 352)

free trade zone (FTZ) (p. 352)

customs drawbacks (p. 352)

shipper's export declaration (SED) (p. 353)

automated export system (AES) (p. 353)

validated export license (p. 353)

general export license (p. 353)

export bill of lading (B/L) (p. 354)

CE (Conformité Européene) mark (p. 354)

customhouse broker (p. 357)

bonded warehouse (p. 357)

Harmonized Tariff Schedule of the United States (HTSA or HTSUS) (p. 357)

Questions

1. In exporting, to what point does the seller pay transportation and delivery costs? Where does the responsibility for loss or damage pass to the buyer? Use Incoterms in your response.
2. Explain the various export payment terms that are available and the protection they offer the seller.
3. What is the procedure for a letter-of-credit transaction?
4. The manager of the international department of the Cape Cod Five Bank learns on the way to work that the ship on which a local exporter shipped some goods to Spain (Wellfleet oysters in salt-water tanks) has sunk in high seas. She has received all the documents required in the letter of credit and is ready to pay the exporter for the shipment. In view of the news about the ship, the manager now knows that the Spanish customer will never receive the goods. Should the manager pay the exporter, or should she withhold payment and notify the overseas customer?
5. What is a foreign trade zone? Check with a customhouse broker or a U.S. Customs official or do some online research to determine the advantages of a foreign trade zone over a bonded warehouse.
6. What are the purposes of an export bill of lading?
7. An importer brings plain sports shirts into the U.S. because the import duty is lower than it is for shirts with adornments. In New Jersey, the importer sews on a figure of a fox. Could the importer do this operation in a foreign trade zone?
8. How would you find sources for a product that you want to import?
9. What does a customhouse broker do?
10. What does a freight forwarder do?

Use the globalEDGE site (<http://globalEDGE.msu.edu/>) to complete the following exercises:

1. You own a small business and, for the first time, are considering exporting. As a new exporter, you want to consult several resources that offer guidance on how to export. Locate the “Trade Tutorials” category on globalEDGE, and identify three sources that you could use to learn more about *exporting*. Provide a description of the services available for new exporters through each of these sources.
2. Your company is planning to expand its operations to Spain. Because countries have different import requirements, top management has requested a report on Spain’s procedures and regulations for imports. Utilize FedEx Country Profiles provided by the FedEx International Resource Center to find the information requested.

Minicase: State Manufacturing Export Sales Price

State Manufacturing Company, a producer of farm equipment, had just received an inquiry from a large distributor in Italy. The quantity on which the distributor wanted a price was sufficiently large that Jim Mason, the sales manager, felt he had to respond. He knew the inquiry was genuine, because he had called two of the companies that the distributor said he represented, and both had assured him that the Italian firm, Agricole Italiana, was a serious one. It paid its bills regularly with no problems. Both companies were selling to the firm on open account terms.

Mason’s problem was that he had never quoted on a sale for export before. His first impulse was to take the regular Ex Works price and add the cost of the extra-heavy export packing plus the inland freight cost to the nearest U.S. port. This price should enable the company to make money if he quoted the price FAS port of exit.

However, the terms of sale were bothering him. The traffic manager had called a foreign freight forwarder to learn about the frequency of sailings to Italy, and during the conversation she had suggested to the traffic manager that she might be able to help Mason. When Mason called her, he learned that because of competition, many firms like State Manufacturing were quoting CIF foreign port as a convenience to the importer. She asked him what payment terms he would quote, and he replied that his credit manager had suggested an irrevocable, confirmed letter of credit to be sure of receiving payment for the sale. He admitted that the distributor, however, had asked for payment against a 90-day time draft.

The foreign freight forwarder urged Mason to consider quoting CIF port of entry in Italy with payment as requested by the distributor to be more competitive. She informed him that

he could get insurance to protect the company against commercial risk. To help him calculate a CIF price, she offered to give him the various charges if he would tell her the weight and value of his shipment FOB factory. He replied that the total price was \$21,500 and that the gross weight, including the container, was 3,629 kilos.

Two hours later, she called to give him the following charges:

1. Containerization	\$ 200.00
2. Inland freight less handling	798.00
3. Forwarding and documentation	90.00
4. Ocean freight	2,633.00
5. Commercial risk insurance	105.00
6. Marine insurance (total of items 1–5 \times 1.1 = \$27,858.60 at 60c/\$100)*	167.15

*Total coverage of marine insurance is commonly calculated on the basis of the total price plus 10 percent.

During that time, Mason had been thinking about the competition. Could he lower the FOB price for an export sale? He looked at the cost figures. Sales expense amounted to 20 percent of the sales price. Couldn’t this be deducted on a foreign order? Research and development amounted to 10 percent. Should this be charged? Advertising and promotional expense amounted to another 10 percent. What about that? Because this was an unsolicited inquiry, there was no selling expense for this sale except for his and the secretary’s time. Mason felt that it wasn’t worth calculating this time.

If you were Jim Mason, how would you calculate the CIF port of entry price?

Appendix: Sample Outline for the Export Business Plan

- I.** Purpose—Why has the plan been written?
- II.** Table of contents—Include a list of any appendixes.
- III.** Executive summary—This is short and concise (not longer than two pages) and covers the principal points of the report. It is prepared after the plan has been written.
- IV.** Introduction—Explains why the firm will export.
- V.** Situation analysis.
 - A.** Description of the firm and products to be exported.
 - B.** Company resources to be used for the export business.
 - C.** Competitive situation in the industry.
 - 1.** Product comparisons.
 - 2.** Market coverage.
 - 3.** Market share.
 - D.** Export organization—personnel and structure.
- VI.** Export marketing plan.
 - A.** Long- and short-term goals.
 - 1.** Total sales in units.
 - 2.** Total sales in dollars.
 - 3.** Sales by product lines.
 - 4.** Market share.
 - 5.** Profit and loss forecasts.
 - B.** Characteristics of ideal target markets.
 - 1.** GNP/capita.
 - 2.** GNP/capita growth rate.
 - 3.** Size of target market.
 - C.** Identify, assess, and select target markets.
 - 1.** Market contact programs.
 - (a)** U.S. Department of Commerce.
 - (b)** World Trade Centers.
 - (c)** Chamber of Commerce.
 - (d)** Company's bank.
 - (e)** State's export assistance program.
 - (f)** Small Business Administration.
 - (g)** Small Business Development Center in local university.
 - (h)** Export hotline directory.
- 2.** Market screening.
 - (a)** First screening—basic need potential.
 - (b)** Second screening—financial and economic forces.
 - (1)** GNP/capita growth rate.
 - (2)** Size of target market.
 - (3)** Growth rate of target market.
 - (4)** Exchange rate trends.
 - (5)** Trends in inflation and interest rates.
 - (c)** Third screening—political and legal forces.
 - (1)** Import restrictions.
 - (2)** Product standards.
 - (3)** Price controls.
 - (4)** Government and public attitude toward buying American products.
 - (d)** Fourth screening—sociocultural forces.
 - (1)** Attitudes and beliefs.
 - (2)** Education.
 - (3)** Material culture.
 - (4)** Languages.
 - (e)** Fifth screening—competitive forces.
 - (1)** Size, number, and financial strength of competitors.
 - (2)** Competitors' market shares.
 - (3)** Effectiveness of competitors' marketing mixes.
 - (4)** Levels of after-sales service.
 - (5)** Competitors' market coverage—Can market segmentation produce niches that are now poorly attended?
 - (f)** Field trips to best prospects.
 - (1)** Department of Commerce trade mission.
 - (2)** Trade missions organized by state or trade association.
- D.** Export marketing strategies.
 - 1.** Product lines to export.
 - 2.** Export pricing methods.

3. Channels of distribution.
 - (a) Direct exporting.
 - (b) Indirect exporting.
4. Promotion methods.
5. After-sales and warranty policies.
6. Buyer financing methods.
7. Methods for ongoing competitor analysis.
8. Sales forecast.

VII. Export financial plan.

- A. Pro forma profit and loss statement.
- B. Pro forma cash flow analysis.
- C. Break-even analysis.

VIII. Export performance evaluation.

- A. Frequency.
 1. Markets.
 2. Product lines.
 3. Export personnel.
- B. Variables to be measured.
 1. Sales by units and dollar volume in each market.
 2. Sales growth rates in each market.
 3. Product line profitability.
 4. Market share.
 5. Competitors' efforts in each market.
 6. Actual results compared to budgeted results.

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