8 Importing, Exporting, and Sourcing

LEARNING OBJECTIVES

8-1 Compare and contrast export selling and export marketing.

8-2 Identify the stages a company goes through, and the problems it is likely to encounter, as it gains experience as an exporter.

8-3 Describe the various national policies that pertain to exports and imports.

8-4 Explain the structure of the Harmonized Tariff System.

8-5 Describe the various organizations that participate in the export process.

8-6 Identify home-country export organization considerations.

8-7 Identify market-country export organization considerations.

8-8 Discuss the various payment methods that are typically used in trade financing.

8-9 Identify the factors that global marketers consider when making sourcing decisions.

CASE 8-1
East-Asian Countries: Export-Led Growth for Economic Success

Few countries have witnessed economic growth as sustained and incredible as the East-Asian countries have over the last 30 years. If the 21st century will be defined as the Asian Century, then the key to this achievement can be traced back to Japan's recipe for economic success. Soon after 1860, when the country was forced to open its borders, Japan's traditional cotton textile industry was wiped out by European goods. By 1914, however, the country was selling half of its automated cotton-spinner-produced yarn abroad, accounting for about a quarter of the global cotton yarn exports. This phenomenon represents the two competing theories of economic development in international trade: import-substitution industrialization (ISI) and export-led growth. ISI is a model of trade and economic growth where a country reduces its share of imported goods by locally producing as much as it can. In a model of export-led growth, a country specializes completely or substantially in export production. These products are usually goods in which the country enjoys comparative advantage.

Which one of these models is more suitable for assuring sustainable and balanced economic growth? This is an age-old debate. There is some factual evidence that low- and middle-income free trade countries have higher economic growth on average. This is why many governments previously advocating ISI began liberalizing trade by the mid-1980s.

Following Japan's astounding growth, the Asian Tigers adopted its trade models. China opened four special economic zones (SEZs) in 1979, and the coastal cities of Shenzhen and Zhuhai became

Exhibit 8-1 Instead of closing up their economies, several countries in East Asia adopted trade policies that promoted exports in targeted industries. After witnessing Japan's astonishing growth before and after World War II, Hong Kong, Singapore, South Korea, and Taiwan, the so-called Asian Tigers, replicated the model for trade and economic growth in the 1960s and 1970s. Since then, the Asian markets have been booming despite periods with financial instabilities, with Hong Kong leading the race.

Source: Imagemore Co., Ltd.

centers of global manufacturing for export production. China is by far the largest export economy in the world. In 2017, China exported \$2.41 trillion and imported \$1.54 trillion, with a positive trade balance of \$873 billion.

Some economists have warned about the limitations of this model, especially during periods of general economic depressions or slumps, and the 2008–2009 global economic crisis has shown some proof of it. Exports from Asia in 2017 reached estimated \$6.398 trillion in 2017. This was a 1.7 percent increase since 2013 but a 2.4 percent fall compared to 2016—not bad for a controversial model of growth! Learn more in the continuation of Case 8-1 at the end of the chapter.

This chapter provides an overview of import–export basics. We begin by explaining the difference between export selling and export marketing. Next is a survey of organizational export activities. An examination of national policies that support exports and/or discourage imports follows. After a discussion of tariff systems, we introduce key export participants. The next section provides an overview of organizational design issues as they pertain to exporting.

This is followed by a section devoted to material that can be extremely useful to undergraduates who are majoring in international business and international marketing: export financing and payment methods. For many students, that all-important first job may be in the import–export department. A familiarity with documentary credits and payment-related terminology can help you make a good impression during a job interview and, perhaps, lead to a job as an export/import coordinator. The chapter ends with a discussion of outsourcing, a topic that is becoming increasingly important as companies in many parts of the world cut costs by shifting both blue-collar and white-collar work to nations with low-wage workforces.

8-1 Export Selling and Export Marketing: A Comparison

◂ **8-1** Compare and contrast export selling and export marketing.

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

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

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

1. An understanding of the target market environment
2. The use of marketing research and identification of market potential
3. Decisions concerning product design, pricing, distribution channels, advertising, and communications—the marketing mix

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

As shown in Exhibit 8-2, one way to visit a potential market is through a **trade show** or a state- or federally sponsored **trade mission**. Each year hundreds of trade fairs, usually organized around a product category or industry, are held in major markets. By attending these events, company representatives can conduct market assessment, develop or expand markets, find distributors or agents, or locate potential end users. Perhaps most important, attending a trade show enables company representatives to learn a great deal about competitors' technology, pricing, and depth of market penetration. For example, exhibits often offer product literature with strategically useful technological information. Overall, company managers or sales personnel should be able to get a good general impression of competitors in the marketplace as they try to sell their own company's product.

Exhibit 8-2 Milan is widely regarded as the design capitol of the world. The year 2016 marked the 55th anniversary of Salon Internazionale del Mobile di Milano ("Milan Furniture Fair"), the world's largest furniture and home furnishings trade fair. Every April, some 2,000 vendors and 300,000 visitors from more than 160 countries converge on Milan to share the latest designs. Many Italian industrial designers are recognizing the necessity of expanding outside the home market. To do that, exports will be key.

Source: Courtesy Salone del Mobile.Milano/ Photo by Andrea Mariani.

8-2 Organizational Export Activities

8-2 Identify the stages a company goes through, and the problems it is likely to encounter, as it gains experience as an exporter.

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

1. The firm is unwilling to export; it will not even fill an unsolicited export order. This may be due to perceived lack of time ("too busy to fill the order") or to apathy or ignorance.
2. The firm fills unsolicited export orders but does not pursue unsolicited orders. Such a firm is an export seller.
3. The firm explores the feasibility of exporting (this stage may bypass stage 2).
4. The firm exports to one or more markets on a trial basis.
5. The firm is an experienced exporter to one or more markets.
6. After this success, the firm pursues country- or region-focused marketing based on certain criteria (e.g., all countries where English is spoken or all countries where it is not necessary to transport by water).
7. The firm evaluates global market potential before screening for the "best" target markets to include in its marketing strategy and plan. *All* markets—domestic and international—are regarded as equally worthy of consideration.

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

One study noted that export procedural expertise and sufficient corporate resources are required for successful exporting.[2] An interesting finding was that even the most experienced exporters express lack of confidence in their knowledge about shipping arrangements, payment procedures, and regulations. The same study also showed that, although profitability is an important expected benefit of exporting, other advantages include increased flexibility and resiliency and improved ability to deal with sales fluctuations in the home market. Although research generally supports the proposition that the probability of being an exporter increases with firm size, it is less clear whether

TABLE 8-1 Potential Export Problems

Logistics	Servicing Exports
Arranging transportation	Providing parts availability
Transport rate determination	Providing repair service
Handling documentation	Providing technical advice
Obtaining financial information	Providing warehousing
Distribution coordination	Sales promotion
Packaging	Advertising
Obtaining insurance	Sales effort
Legal procedures	Marketing information
Government red tape	Foreign market intelligence
Product liability	Locating markets
Licensing	Trade restrictions
Customs/duty	Competition overseas
Contract	
Agent/distributor agreements	

export intensity—that is, the ratio of export sales to total sales—is positively correlated with firm size. Table 8-1 lists some of the export-related problems that a company typically faces.

▸ **8-3** Describe the various national policies that pertain to exports and imports.

8-3 National Policies Governing Exports and Imports

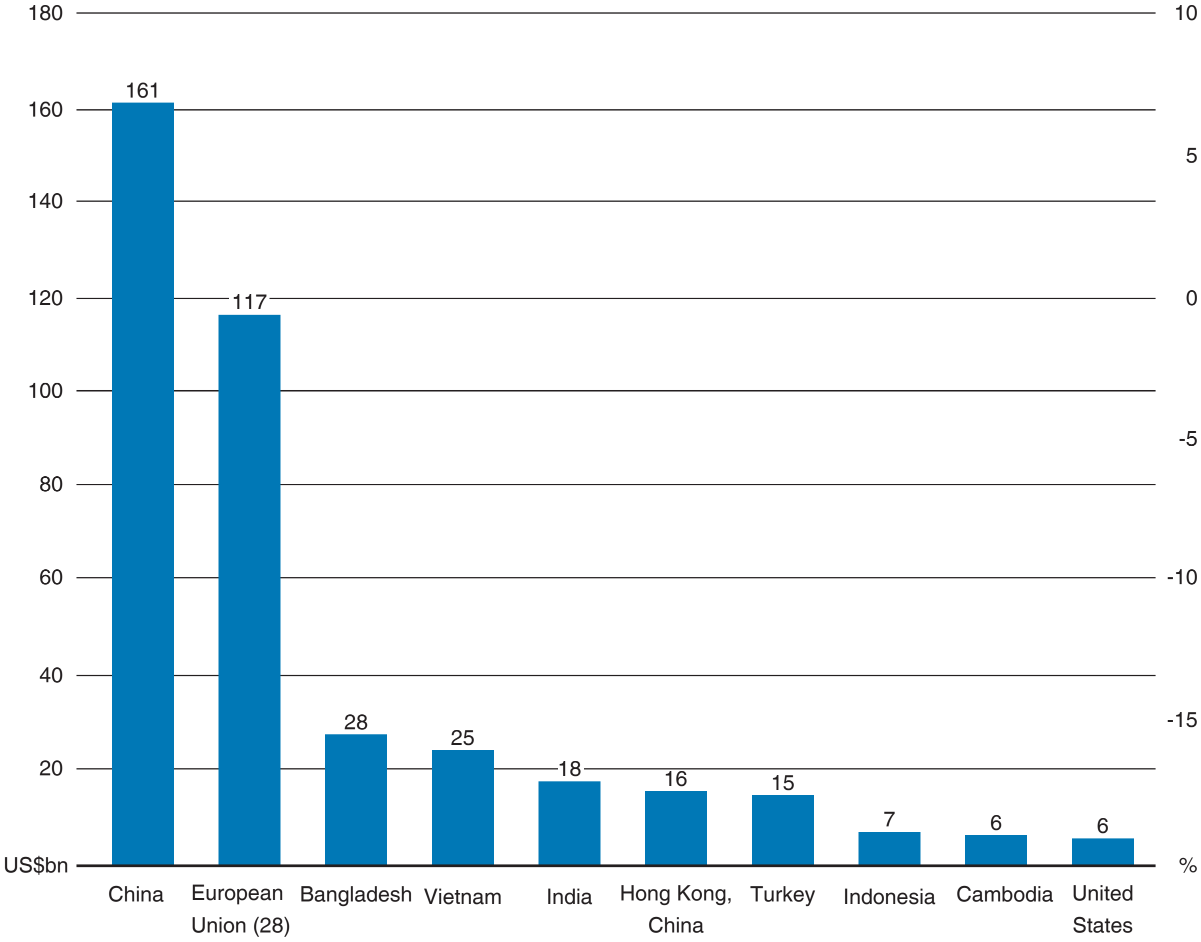
It is hard to overstate the impact of exporting and importing on the world's national economies. In 1997, for example, total imports of goods and services by the United States passed the $1 trillion mark for the first time; in 2017, the combined total was $2.9 trillion. European Union (EU) imports, counting both intra-EU trade and trade with non-EU partners, totaled more than $3 trillion. Trends in both exports and imports reflect China's pace-setting economic growth in the Asia-Pacific region. Exports from China have grown significantly in the years since China joined the World Trade Organization (WTO). As shown in Table 8-2, Chinese apparel exports surpass those of other countries by a wide margin. Historically, China protected its own producers by imposing double-digit import tariffs, but these tariffs have been reduced as China has sought to comply with WTO regulations.

Needless to say, representatives of the apparel, footwear, furniture, and textile industries in many countries are deeply concerned about the impact that increased trade with China will have on these sectors. As this example suggests, one word can summarize national policies toward exports and imports: contradictory. For centuries, nations have combined two opposing policy attitudes toward the movement of goods across national boundaries. On the one hand, nations directly encourage exports; on the other hand, they generally restrict the flow of imports.

Government Programs That Support Exports

To see the economic boost that can come from a government-encouraged export strategy, consider Japan, Singapore, South Korea, and the so-called Greater China or "China triangle" market, which includes Taiwan, Hong Kong, and the People's Republic of China. After recovering from the destruction of its economy during World War II, Japan became an economic superpower as a direct result of export strategies devised by the Ministry for International Trade and Industry (MITI). The four tigers—Singapore, South Korea, Taiwan, and Hong Kong—learned from the Japanese experience and built strong export-based economies of their own. Although Asia's "economic bubble" burst in 1997 as a result of uncontrolled growth, Japan and the tigers are moving forward in the twenty-first century at a more moderate rate. China, an economy unto itself, has attracted increased foreign

TABLE 8-2 Top 10 Clothing Exporters 2016 (U.S.$ billions)



investment from Daimler AG, General Motors (GM), Hewlett-Packard, and scores of other companies that are setting up production facilities to support local sales, as well as exports to world markets.

Any government concerned with trade deficits or economic development should focus on educating firms about the potential gains from exporting. Policymakers should also remove bureaucratic obstacles that hinder company exports. This is true at the national, regional, and local government levels. In India, for example, leaders in the state of Tamil Nadu gave Hyundai permission to operate its plant around the clock, making it the first Hyundai operation anywhere in the world to operate on a 24-hour basis (see Exhibit 8-3).[3]

Exhibit 8-3 A worker finishes a K-Series engine at the Maruti Suzuki assembly line in Gurgaon, India. Maruti Suzuki is one of India's leading auto manufacturers. However, foreign investment in the automotive sector is exploding as Ford, Honda, Nissan, Toyota, and other companies rush to capitalize on growing Indian demand for passenger cars.

Source: Gurinder Osan/Associated Press.

Governments commonly use four activities to support and encourage firms that engage in exporting: tax incentives, subsidies, export assistance, and free trade zones.

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

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

Governments also support export performance by providing outright **subsidies**, which are direct or indirect financial contributions or incentives that benefit producers. Subsidies can severely distort trade patterns when less competitive but subsidized producers displace competitive producers in world markets. Organisation for Economic Co-operation and Development (OECD) members spend nearly $400 billion annually on farm subsidies; currently, total annual farm support in the EU is estimated at $100 billion. With approximately $40 billion in annual support, the United States has the highest subsidies of any single nation. Agricultural subsidies are particularly controversial because, although they protect the interests of farmers in developed countries, they work to the detriment of farmers in developing areas such as Africa and India.

The EU has undertaken an overhaul of its **Common Agricultural Policy (CAP)**, which critics have called "as egregious a system of protection as any" and "the single most harmful piece of protectionism in the world."[5] In May 2002, much to Europe's dismay, U.S. President George W. Bush signed a $118 billion farm bill that actually *increased* subsidies to American farmers over a 6-year period. The Bush administration took the position that, despite the increases, overall U.S. subsidies were still lower than those in Europe and Japan; Congress voted to extend the farm bill for another 5 years.

Another means of supporting exporters is by extending *governmental assistance* to exporters. Companies can avail themselves of a great deal of government information concerning the location of markets and credit risks. Assistance may also be oriented toward export promotion. Government agencies at various levels often take the lead in setting up trade fairs and trade missions designed to promote sales to foreign customers.

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

Governmental Actions to Discourage Imports and Block Market Access

Measures such as tariffs, import controls, and a host of nontariff barriers are designed to limit the inward flow of goods. **Tariffs** can be thought of as the "three Rs" of global business: rules, rate schedules (duties), and regulations of individual countries. ("Tariff" is an ancient trading term derived from the Arabic word "ta'rif", which means "information" or "notification.")[6] Duties on individual products or services are listed in the schedule of rates (see Table 8-3). One expert on global trade defines **duties** as "taxes that punish individuals for making choices of which their governments disapprove."[7]

TABLE 8-3 Examples of Trade Barriers

Country/Region	Tariff Barriers	Nontariff Barriers
European Union	16.5% antidumping tariff on shoes from China, 10% on shoes from Vietnam	Quotas on Chinese textiles
China	Tariffs as high as 28% on foreign-made auto parts	Expensive, time-consuming procedures for obtaining pharmaceutical import licenses

As noted in earlier chapters, a major U.S. objective in the Uruguay Round of General Agreement on Tariffs and Trade (GATT) negotiations was to improve market access for U.S. companies with major U.S. trading partners. When the Uruguay Round ended in December 1993, the United States had secured reductions or total eliminations of tariffs on 11 categories of U.S. goods exported to the EU, Japan, five of the European Free Trade Association (EFTA) nations (Austria, Switzerland, Sweden, Finland, and Norway), New Zealand, South Korea, Hong Kong, and Singapore. The categories affected included equipment for the construction, agricultural, medical, and scientific industry sectors, as well as steel, beer, brown distilled spirits, pharmaceuticals, paper, pulp and printed matter, furniture, and toys. Most of the remaining tariffs were phased out over a 5-year period. A key goal of the ongoing Doha Round of WTO trade talks is the reduction in agricultural tariffs, which currently average 12 percent in the United States, 31 percent in the EU, and 51 percent in Japan.

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

In spite of the progress made in simplifying tariff procedures, administering a tariff is an enormous burden. People who work with imports and exports must familiarize themselves with the different classifications and use them accurately. Even a tariff schedule of several thousand items cannot clearly describe every product traded globally. Plus, the introduction of new products and new materials used in manufacturing processes creates new problems. Often, determining the duty rate on a particular article requires assessing how the item is used or determining its main component material. Two or more alternative classifications may have to be considered.

A product's classification can make a substantial difference in the duty applied. For example, is a Chinese-made *X-Men* action figure a doll or a toy? For many years, dolls were subject to a 12 percent duty when imported into the United States; the rate was 6.8 percent for toys. Moreover, action figures that represent nonhuman creatures such as monsters or robots were categorized as toys and, therefore, qualified for lower duties than human figures that the Customs Service classified as dolls. Duties on both categories have been eliminated; however, the Toy Biz subsidiary of Marvel Enterprises spent nearly 6 years on an action in the U.S. Court of International Trade to prove that its *X-Men* action figures do not represent humans. Although the move appalled many fans of the mutant superheroes, Toy Biz hoped to be reimbursed for overpayment of past duties made when the U.S. Customs Service had classified imports of Wolverine and his fellow figures as dolls.[8]

One of the most controversial aspects of U.S. Donald Trump's "America First" policy was his decision to impose tariffs on imports of steel and aluminum (see Exhibit 8-4). Opponents of this policy—including trade partners and some U.S. industry leaders—argue that the tariffs will negatively impact the U.S. economy and invite retaliation from abroad.

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

Exhibit 8-4 President Donald Trump's decision to impose tariffs on steel and aluminum imports was hailed by some an important step toward reversing unemployment in America's Rust Belt.
Source: DAVID HECKER/EPA-EFE/Shutterstock.

A **quota** is a government-imposed limit or restriction on the number of units or the total value of a particular product or product category that can be imported. Generally, quotas are designed to protect domestic producers. In 2005, for example, textile producers in Italy and other European countries were granted quotas on 10 categories of textile imports from China. The quotas, which were scheduled to run through the end of 2007, were designed to give European producers an opportunity to prepare for increased competition.[9]

Discriminatory procurement policies can take the form of government rules, laws, or administrative regulations requiring that goods or services be purchased from domestic companies. For example, the Buy American Act of 1933 stipulates that U.S. federal agencies and government programs must buy goods produced in the United States. The act does not apply if domestically produced goods are not available, if the cost is unreasonable, or if "buying local" would be inconsistent with the public interest. Similarly, the Fly American Act states that U.S. government employees must fly on domestic carriers whenever possible.

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

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

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

As discussed in earlier chapters, there is a growing trend to remove all such restrictive trade barriers on a regional basis. The largest single effort was undertaken by the EU and resulted in

ENTREPRENEURIAL LEADERSHIP, CREATIVE THINKING, AND THE GLOBAL STARTUP

Oscar Farinetti, Eataly

Oscar Farinetti is an entrepreneur. He developed an innovative retail concept, Eataly, and started a company to market it. By applying the basic tools and principles of modern global marketing, Farinetti has achieved remarkable success. As is true with many entrepreneurs, Farinetti's idea was based on a crucial insight about his native country. His hometown is Alba, the birthplace of the Slow Food movement and the source of world-famous white truffles. Farinetti also owns two wineries in the Barolo appellation, which is renowned for its red wines. Farinetti realized that Italy's two great resources, its artistic heritage and its biodiversity, represented an opportunity for innovation.

Farinetti made a fortune when he sold UniEuro, the appliance company that evolved from his family's supermarket, for €500 million. Guided by the principle that it is important to "put a little poetry" into his personal endeavors, he turned his attention from washing machines to food. This was a natural move, considering that the root of Farinetti's family name is *farina*, the Italian word for flour. A turning point for Farinetti was a visit to Istanbul's Grand Bazaar, where he was captivated by the sights, sounds, and smells.

Starting in 2007 with a single location in Turin, Italy, Farinetti now presides over a far-flung global empire of Eataly megastores that celebrate all things Italian (see Exhibit 8-5). Armed with the tagline "Italy is Eataly," Farinetti has opened more than 25 stores in major cities such as Chicago, Dubai, and New York City. In addition to the original store in Turin, there are now numerous other locations in Italy as well.

Eataly gourmet supermarkets, and the restaurants tucked inside them, are helping Italian food producers during Italy's ongoing recession. Overall, Italy's retail sector has pursued very little international expansion; by contrast, other European supermarket chains such as Tesco (United Kingdom), Metro (Germany), and Carrefour (France) took local products and brands with them as they expanded around the globe.

Some Italian food brands, such as Ferrero (Nutella) and Barilla (pasta), are well known throughout the world. However, many of Italy's food companies, which represent about 15 percent of the country's overall economy, lack the money or the managerial expertise to export. As noted in Chapter 3, Italy boasts myriad product categories that carry designations such as Denominazione Origine Controllata e Garantita (DOCG) and Denominazione Origine Protetta (DOP). Such a designation means, for example, that cheese marketed as Parmigiano-Reggiano can only be made from cow's milk from a certain part of Italy. Eataly's success has helped small-scale, artisanal wine, cheese, and prosciutto producers to reach new customers who are willing to pay premium prices for Italian quality and authenticity.

Many observers note that the "Made in Italy" movement got an additional boost from the 2015 World Expo in Milan. The theme of the Expo was "Feeding the Planet. Energy for Life." Perhaps not surprisingly, the Italian Pavilion showcased Italy's national food culture. Needless to say, Eataly was present at the 2015 Expo: Eataly Milan Smeraldo opened months before the Expo itself.

Farinetti is optimistic about Italy's future. "We need to double tourism in Italy, we can double our export of food and agriculture products, we need to open up other industries of fashion, design, industrial manufacturing. And if we manage this we will bring the country to another renaissance," he says.

Sources: Manuela Mesco, "Corporate News: Prices Pinch Prosciutto Trade," *The Wall Street Journal* (January 2, 2015), p. B3; Elisabeth Rosenthal, "The Fantasy Italy," *The New York Times Sunday Review* (August 3, 2014), p. 3; Robert Camuto, "Eataly: A Revolutionary Approach to Italian Food and Wine," *Wine Spectator* (April 30, 2013), pp. 30–33+; Rachel Sanderson, "Food: The New Frontier for Italian Luxury," *Financial Times* (December 23, 2014), p. 5; Rachel Sanderson, "Matteo Renzi's Favourite Deli Man," *Financial Times* (May 28, 2014), p. 10.

Exhibit 8-5 After analyzing the Italian food market, Oscar Farinetti realized that there were plenty of large stores with wide selections but low quality and low prices. There were also small stores with small selections but high quality and high prices. With Eataly, Farinetti offers consumers the best of both worlds: a wide selection of high-quality products with reasonable prices.
Source: Piero Oliosi/Polaris/Newscom.

THE CULTURAL CONTEXT

International Education for Chinese Students = Service Exports for Host Countries

As noted in Chapter 7, newly affluent Chinese parents invest heavily in their children's educations, due in large part to the fact that many of the parents themselves did not go to college. (In fact, the term "rich redneck" is sometimes applied to this segment as a put-down.) There is a sense among some families that they neither command the respect nor have the influence of China's super-elite. Anxious for their children to earn respect, many parents enroll them in private international schools in China, starting as early as kindergarten. Alternatively, many students take international classes at public schools. In either case, wealthy Chinese parents are under enormous social pressure to ensure that their children get an international education, starting at the K–12 level.

Of course, international education is expensive. However, since 2000, average household wealth in China has increased 600 percent. As a consequence, more Chinese parents are both willing and able to invest in their children's educations.

Many of these same parents aspire to send their children abroad to attend college (see Exhibit 8-6). Australia, Japan, Germany, the United Kingdom, and the United States are favorite destinations. In the United States alone, 350,755 Chinese students were enrolled in U.S. higher education institutions in 2017. That figure represents one-third of the total international student population in the United States and is triple the number of a decade ago. The University of Southern California is currently the number 1 destination for students from China. India, South Korea, Saudi Arabia, and Canada also send tens of thousands of students to the United States each year.

One reason that Chinese and other international students are welcome at colleges and universities around the world is that they generally pay higher tuition charges, and they frequently pay those fees in cash. Such students are viewed by educational institutions as important revenue sources, especially in the United States where declining enrollments and growing concerns about student debt are affecting many colleges and universities. In fact, in any given calendar year, international students contribute more than $35 billion to the U.S. economy. One barrier to extending financial aid to Chinese students is the absence of any mechanism to check the credit scores of the parents.

Until recently, business schools in North America and Europe offering MBA programs benefited from an influx of Chinese students. The reason was simple: Applicants perceived Western MBA programs to be superior to those available at home. Indeed, for many years, the majority of Chinese who studied abroad were graduate students. That situation is changing now, and the number of undergraduate students has surpassed the number of graduate students. One reason for this trend: A growing number of Chinese institutions have received accreditation, including the China Europe International Business School (CEIBS) in Shanghai. As a result, many Chinese students seeking graduate degrees are opting to "go local."

Meanwhile, concern is mounting that Beijing is using "soft power" to extend its influence in schools and universities by sponsoring an initiative known as the Confucius Institute. The Confucius Institute is administered by Hanban, which is affiliated with China's education ministry. With a presence in more than 140 countries, the officially stated mission of the Confucius Institute is to promote the study of the Chinese language. The initiative is welcomed on many campuses where budgets are stretched and language programs have been curtailed. However, critics say that the Confucius Institutes allow the Chinese government to present a carefully scripted picture of China today.

Sources: Bei Guo and Zhengyu Huang, "Chinese Students in America," Solo Session, SXSW Interactive, Austin, Texas (March 13, 2018); Emily Feng, "Academics Fear Spread of China's Soft Power on West's Campuses," *Financial Times* (October 30, 2017), p. 6; Joshua Chaffin, "'Tiger Mums' Look to UK's First English–Chinese Primary School," *Financial Times* (October 9, 2017), p. 3; Jonathan Moules, "WeChat Replaces Textbooks in MBA Classrooms," *Financial Times* (October 2, 2017), p. 15; Jonathan Moules, "Business Advantage Brings China's Students Home," *Financial Times* (September 25, 2017), p. 15; Brook Larmer, "The New Kids," *The New York Times Magazine* (February 5, 2017), pp. 40–45; Brian Groom, "Fears over Loss of Billions from Overseas Students," *Financial Times—FT Special Report: Destination North of England* (April 15, 2016), p. 2; Te-Ping Chen, "China Curbs Elite Programs Aimed at Overseas Study," *The Wall Street Journal* (December 21, 2015), p. A19; Te-Ping Chen and Melissa Korn, "Colleges Pay a Price for Foreign Students," *The Wall Street Journal* (October 1, 2015), pp. A1, A14.

Exhibit 8-6 Chinese students study abroad to gain a wider perspective, to find a better educational environment, and to enrich their knowledge. Many return to China after receiving their degrees. These students showed their support for President Xi Jinping during his visit to Manchester, England, in 2015.

Source: Richard Stonehouse/Getty Images.

TABLE 8-4 Sample Rates of Duty for U.S. Imports

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

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

the creation of a single market starting January 1, 1993. The intent of this agreement was to have one standard for all of Europe's industry sectors, including automobile safety, drug testing and certification, and food and product quality controls. The introduction of the euro has also facilitated trade and commerce within the euro zone.

8-4 Tariff Systems

8-4 Explain the structure of the Harmonized Tariff System.

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

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

Table 8-5 shows a detailed entry from Chapter 89 of the Harmonized Tariff System pertaining to "Ships, Boats, and Floating Structures" (for explanatory purposes, each column has been identified with an alphabet letter). Column A contains the heading-level numbers that uniquely identify each product. For example, the product entry for heading level 8903 is "Yachts and other vessels for pleasure or sports; rowboats and canoes." Subheading level 8903.10 identifies "Inflatable"; 8903.91 designates "Sailboats with or without auxiliary motor." These six-digit numbers are used by more than 100 countries that have signed on to the HTS. Entries can extend to as many as 10 digits, with the last 4 digits used on a country-specific basis for each nation's individual tariff and data collection purposes. Taken together, columns E and F correspond to column 1 in Table 8-4, and column G corresponds to column 2 in Table 8-4.

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

A **preferential tariff** is a reduced tariff rate applied to imports from certain countries. GATT prohibits the use of preferential tariffs, with three major exceptions. First are historical preference arrangements such as the British Commonwealth preferences and similar arrangements that existed before GATT. Second, preference schemes that are part of a formal economic integration

TABLE 8-5 Chapter 89 of the Harmonized Tariff System

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

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

treaty, such as free trade areas or common markets, are excluded. Third, industrial countries are permitted to grant preferential market access to companies based in less-developed countries.

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

During the Uruguay Round of GATT negotiations, the United States successfully sought a number of amendments to the Agreement on Customs Valuations. Most important, the United States wanted clarification of the rights and obligations of importing and exporting countries in

TABLE 8-6 Tariff Rates for China, NTR versus Non-NTR

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

Source: U.S. Customs Service.

cases where fraud was suspected. Two overall categories of products were frequently targeted for investigation. The first included exports of textiles, cosmetics, and consumer durables; the second included entertainment software such as videotapes, audiotapes, and compact discs. Such amendments improve the ability of U.S. exporters to defend their interests if charged with fraudulent practices. The amendments were also designed to encourage nonsignatories, especially developing countries, to become parties to the agreement.

Customs Duties

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

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

A *specific duty* is expressed as a specific amount of currency per unit of weight, volume, length, or other unit of measurement—for example, "50 cents U.S. per pound," "$1.00 U.S. per pair," or "25 cents U.S. per square yard." Specific duties are usually expressed in the currency of the importing country, but there are exceptions, particularly in countries that have experienced sustained inflation.

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

Other Duties and Import Charges

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

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

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

▶ **8-5** Describe the various organizations that participate in the export process.

8-5 Key Export Participants

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

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

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

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

An **export management company (EMC)** is an independent marketing intermediary that acts as the export department for two or more manufacturers (principals) whose product lines do not compete with each other. Although the EMC usually operates in the name of its principals for export markets, it may also operate in its own name. This company may act as an independent distributor, purchasing and reselling goods at an established price or profit margin. Alternatively, it may act as a commissioned representative, taking no title and bearing no financial risks in the sale. According to one survey of U.S.-based EMCs, the most important activities for export success are gathering marketing information, communicating with markets, setting prices, and ensuring parts availability. The same survey ranked export activities in terms of degree of difficulty; analyzing political risk, sales force management, setting pricing, and obtaining financial information were found to be the most difficult to accomplish. One of the study's conclusions was that the U.S. government should do a better job of helping EMCs and their clients analyze the political risk associated with foreign markets.[10]

Another type of intermediary is the **manufacturer's export agent (MEA)**. Much like an EMC, the MEA can act as an export distributor or as an export commission representative. However, the MEA does not perform the functions of an export department, and the scope of its market activities is usually limited to a few countries.

An **export distributor** does assume financial risk as part of the export process. Because this party usually represents several manufacturers, it is sometimes known as a *combination export manager*. The export distributor usually has the exclusive right to sell a manufacturer's products in all or some markets outside the country of origin. The distributor pays for the goods and assumes all financial risks associated with the foreign sale; it also handles all shipping details. The agent ordinarily sells at the manufacturer's list price abroad; compensation comes in the form of an agreed percentage of the list price. The distributor may operate in its own name or in the manufacturer's name.

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

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

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

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

8-6 Organizing for Exporting in the Manufacturer's Country

◀ **8-6** Identify home-country export organization considerations.

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

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

A company that assigns a sufficiently high priority to its export business will establish an in-house organization. It then faces the question of how to organize this function effectively. The most appropriate approach depends on two things: the company's appraisal of the opportunities in export marketing and its strategy for allocating resources to markets on a global basis. It may be possible for a company to make export responsibility part of a domestic employee's job description. The advantage of this arrangement is obvious: It is a low-cost arrangement requiring no additional personnel. However, this approach can work only under two conditions: (1) The domestic employee assigned to the task must be thoroughly competent in terms of product and customer knowledge and (2) that competence must be applicable to the target international market(s). The key issue underlying the second condition is the extent to which the target export market is different from the domestic market. If customer circumstances and characteristics are similar, the requirements for specialized regional knowledge are reduced.

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

▸ **8-7** Identify market-country export organization considerations.

8-7 Organizing for Exporting in the Market Country

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

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

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

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

▸ **8-8** Discuss the various payment methods that are typically used in trade financing.

8-8 Trade Financing and Methods of Payment[11]

The need for a company to be paid for its export sales should be obvious. Yet, many who are new to international trade consider this issue only as an afterthought. Experienced exporters and importers (sellers and buyers) consider the financial and shipping terms of a transaction to be a normal part of any negotiation. In fact, settling the details of a transaction is a valuable act of discipline for all parties to limit future misunderstandings or conflicts. The credit and collection functions are both art and science and require ongoing senior management oversight. There is no "one size fits all" approach to trade finance. Naturally, from a marketing perspective, a firm needs to ensure its terms of sale are competitive.

Selling across borders is inherently riskier than selling within one's home country. Managers may have only limited understanding of topics covered in previous chapters of this book, including language, cultural differences, and foreign political environments. Another reality is that, outside of the OECD economies, a firm will have no effective legal recourse if difficulties arise. Those engaging in international trade must manage the central risks of "nonpayment" and "nonperformance" by their business partners—situations where the exporter might not receive payment for its goods or where the importer might not receive what had been promised. Fortunately, the international banking system plays a critical role in enabling successful international commerce by reducing these transaction risks. Before taking up a discussion of banking's role, however, we need to highlight two basic methods of payment: cash with order and open account.

Cash with order (CWO) presents the least transaction risk to the exporter. In this payment arrangement, the exporter sends the importer a **pro-forma invoice** [a Latin term meaning "before the fact" or "for the sake of form"] with the details and costs of a future shipment. The financial figures and other information are nonbinding, but will be reflected in the future actual invoice. After receiving this "proforma," the importer then sends its purchase order with prepayment

(CWO) to the exporter. While beneficial to the exporter, this presents risks for the importer: Although the importing firm has sent funds to the exporter, it has no assurance of shipment.

Open account payment presents the greatest transaction risk to the exporter. In this arrangement, the importer sends a purchase order to the exporter, which then produces, ships, and subsequently invoices the importer for the shipment. The importer then remits payment to the exporter via wire transfer. While beneficial to the importer, this scheme is risky for the exporter because, even though it has made the requested shipment, there is no assurance of payment.

Letters of Credit

While the CWO and open account payment methods both carry risks, they may be used when two companies have a longstanding, mutually beneficial relationship with each other. However, for most firms entering cross-border business with a new commercial partner, the risks of nonpayment or nonperformance are simply too great, and failure could put their companies at risk.

This is where the banking system helps manage the risk via a key document called the **letter of credit (L/C)** (also known as a *documentary credit*). An L/C substitutes a bank's creditworthiness for that of the importer. From the exporter's perspective, if it ships and "performs" under an L/C, it can rely on the full faith and credit of that bank for payment—not the creditworthiness of the buyer. At the same time, the importer is not obligated to pay for the shipment unless and until the exporter has performed under the terms specified in the L/C. Performance is demonstrated when the exporter provides the buyer's bank with a *documentary package*. This agreed-upon set of documents, which are listed in the L/C, collectively demonstrates that the exporter has performed as agreed.

The importer's bank is known as the "issuing" or "opening" bank. At the request of the buyer, it "opens" an L/C "in favor of" the exporter, which is thereafter referred to as the "beneficiary." In some instances, the opening bank may require the importer to deposit funds or provide collateral against the L/C because the bank is, in essence, extending its own credit on behalf of the importer. However, if there is an established relationship between the bank and the importer, this requirement may be waived. The now-opened L/C is sent to the exporter's bank, which then advises the exporter that an L/C has been opened in its favor. The exporter's bank is referred to as the "negotiating" or "advising" bank.

The most common type of L/C is an **irrevocable letter of credit**. As the name implies, the bank issuing the L/C cannot cancel ("revoke") or modify the L/C terms without obtaining approval from both the exporter and the importer. The key point, from the exporter's perspective, is that even if the importer subsequently cancels the order or fails to pay for the merchandise, the opening bank remains obligated to pay the exporter so long as the exporter has fulfilled the terms given in the L/C.

If the exporter desires (at its prerogative), it can secure an extra layer of protection (for a fee) by asking its advising bank to confirm the L/C of the opening bank. Such a confirmation adds the full faith and credit of the exporter's bank on top of the existing pledge by the importer's bank. If the buyer's opening bank ultimately does not or cannot pay—due, for example, to government-imposed currency controls—the exporter is still guaranteed payment by its own bank. In this scenario, the exporter is said to be operating under a **confirmed irrevocable letter of credit**. Bank fees for opening an L/C vary by country and commercial risk, but can range from ⅛% to 1% of the total credit. Banks charge similar fees for confirming an L/C.

After being satisfied that it can perform under the L/C terms, the exporter will produce and ship the product to the importer. The exporter then assembles the group of documents listed in the L/C. As noted earlier, the L/C includes an agreed-upon (by buyer and seller) list of documents that will be considered evidence of the seller's performance. This documentary package often includes commercial invoices, drafts, packing lists, certificates of insurance, certificates of origin, and ocean bills of lading (which represent title to the shipment). The documentary package and the L/C are sent via the advising (or now confirming) bank and "presented" to the buyer's opening bank. The buyer's bank reviews the documentary package and, if all is in order, will "honor" the credit.

If the transaction is conducted under a *sight draft*, the bank will promptly transfer payment to the beneficiary. If the exporter had agreed to extended credit terms, the draft in the documentary package would be a *time draft* and the bank would remit payment after that agreed-upon period. At this point, for the importer to take possession of the shipment, the opening bank will arrange for the buyer to make its payment, either at sight or at the later time given in the time draft. Upon the importer paying the opening bank or signing a *promissory note* (pledging to make the future payment), the bank will release the documentary package to the buyer. This package includes the ocean bills of lading (and thus title to the goods), enabling the importer to take possession of those goods from the freight carrier. In this process, it is important to note that banks operate only against documents—not on handshakes, contracts, or the shipment's physical move.

Documentary Collections (Sight or Time Drafts)

Over time, an exporter and an importer may establish a good working relationship and decide to move to a simpler, less-complicated form of payment called **documentary collection**. Engaging in such an arrangement requires the exporter to balance the high risk of shipping under open account against the burdensome but low risk of operating under an L/C. Banks are again involved as intermediaries, but provide no guarantees or credit. With a documentary collection, using either a sight draft or time draft, the exporter produces and ships the ordered product. The documentary package, including a draft, is sent to the exporter's correspondent bank (working on behalf of the exporter) in the buyer's country. The importer goes to the bank and makes payment per the terms specified in the draft. In the case of a sight draft (a process known as *documents against payment*), title to the goods passes to the importer when it makes payment to the bank and the bank releases the shipping documents (including bills of lading representing title to the goods). Again, this is separate from the physical movement of the goods.

For the exporter, a higher-risk variation involves a time draft (a process known as *documents against acceptance*). In this case, the exporter would again send a draft and documentary package to its correspondent bank. There, the buyer signs and thus "accepts" the time draft (now a formal obligation for payment at a future date) in exchange for the document package from the correspondent bank. When the accepted time has elapsed, the correspondent bank collects and relays the payment from the importer.

Neither of these options protects the exporter from a buyer that cancels a shipment or refuses to pay. Also, *documents against acceptance* has the added risk of a buyer taking physical possession without payment.

Navigating the Real World: A Brief Case Study

While operating under an L/C is often preferred, in some markets that arrangement is not possible. Bayer, a leader in global life sciences and pharmaceuticals, manages a complex non-L/C payment process to provide vital medicines to the people of Venezuela. Bayer's production costs are based in hard-currency countries, so it ultimately needs hard currency to cover those costs. Yet, in Venezuela, its medicines are purchased in bolivars, the country's volatile and rapidly depreciating currency. Moreover, Nicolás Maduro's government has imposed stringent currency controls. How, then, does Bayer manage payments for its medicines in Venezuela?

In a multistep process, Bayer sells to the Venezuelan government's national health insurance plan and receives payment in bolivars. Bayer then has to negotiate with the government to change those bolivars into U.S. dollars (or euros) at various levels of exchange (there are even different rates among medicines). Once the payment is converted, Bayer still needs government permission to transfer the money out of the country. These hard-currency payments from the government are arranged under a form of *documents against acceptance*. Title to the medicines (shown in the documents) is passed to the government when it signs ("accepts") a Bayer time draft that stipulates the future negotiated payment date, currency amount, and future bolivar/dollar exchange rate.

Naturally, Bayer's preference would be to operate under an L/C—but that would offend the government and might lead to having company officers arrested and their families harassed. A further complication is that, at times, the government simply defaults. Bayer, the beneficiary, then must renegotiate terms with the government to convert the documents against acceptance into Venezuelan government bonds denominated in U.S. dollars with yet another maturity date. Unfortunately, the government offers such bonds only at a discount from the original agreed-upon payment.

Once the bonds are received, Bayer immediately sells them at yet a further discount, resulting in receipts that are 25 to 35 percent below the original invoice. Given Venezuela's high rate of inflation—more than 800 percent in 2017—and the falling value of the bolivar, Bayer's management focus is on cash flow and the timely receipt of receivables, and less on the absolute amounts received. Despite this major difficulty, Bayer's senior management remains committed to the market and recognizes their ethical obligation to support society's health care. Bayer, and many other global firms, look forward to the day when Venezuela's political and economic environments become more stable. Dieter Weinand, head of Bayer Pharma notes, "Each set of countries, customers, and intermediaries requires a unique approach. Credit and collection is an art and science unto itself and it takes an army of people to do this work."

Navigating the Real World: Another Brief Case Study

Subaru's history in the United States provides another good case study in the importance of L/Cs. Today, Subaru is a highly regarded global brand. Fifty years ago, however, it was a different story. In the late 1960s, entrepreneurs Malcolm Bricklin and Harvey Lamm set up Subaru of America (SOA) in Cherry Hill, New Jersey, and began importing the Subaru 360 from Japan. The parent company, Fuji Heavy Industries, initially agreed to a 5-year commitment. When Bricklin and Lamm asked to extend the agreement in perpetuity, Fuji insisted on several concessions. As described by Randall Rothenberg:

> All payment, the manufacturer told Subaru of America, must now be made up front. If the Americans could not get the cash from their dealers, then they would have to get the money from banks. S.O.A., the new contract read, could "order vehicles or equipment only upon the presentation to Fuji of an irrevocable letter of credit to cover the invoice price and in some cases freight for all items ordered." The letters of credit would be opened the moment Fuji placed vehicles on the boats in Yokohama, and would be payable no later than 180 from the shipment date.[12]

For several months, U.S. sales of the 360 boomed. Then, in April 1969, *Consumer Reports* road-tested the 360 and rated it "Unacceptable"; demand for the vehicle evaporated. SOA's dealers quit ordering (and paying for) additional cars, so Bricklin and Lamm had no funds to pay Fuji ("up front," as noted above). Fuji then collected on the L/Cs; SOA could not reimburse the banks, and defaulted on its credit agreements. The bad credit history meant that no banks would provide letters of credit; SOA was at risk of having its import agreement canceled. Ultimately, Malcolm Bricklin was forced out of the company. Subaru of America found new sources of financing, and began assembling a dealer network in rural America. The rest, as the saying goes, is history: Today Subaru has some of the best reviewed, best-selling cars on the market.

Additional Export and Import Issues

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

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

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

Another issue with imports and exports is *duty drawback*—that is, refunds of duties paid on imports that are processed or incorporated into other goods and then reexported. Drawbacks have long been used in the United States to encourage exports. However, when NAFTA was negotiated, the U.S. trade representative agreed to restrict drawbacks on exports to Canada and Mexico. As the United States negotiates new trade agreements, some industry groups are lobbying in favor of keeping drawbacks.[13] Duty drawbacks are also common in protected economies and represent a policy instrument that aids exporters by reducing the price of imported production inputs. China was required to remove duty drawbacks as a condition for joining the WTO. As duty rates around the world fall, the drawback issue will become less important.

▶ **8-9** Identify the factors that global marketers consider when making sourcing decisions.

8-9 Sourcing

In global marketing, the issue of customer value is inextricably tied to the **sourcing decision**: whether a company makes or buys its products as well as *where* it makes or buys its products. **Outsourcing** means shifting production jobs or work assignments to another company to cut costs. When the outsourced work moves to another country, the terms *global outsourcing* and *offshoring* are sometimes used. In today's competitive marketplace, companies are under intense pressure to lower costs; one way to do this is to locate manufacturing and other activities in China, India, and other low-wage countries. And why not? Many consumers do not know where the products they buy—athletic shoes, for example—are manufactured (see Exhibit 8-7). It is also true that, as Case 1-1 in Chapter 1 indicated, people often can't match corporate and brand names with particular countries.

In theory, this situation bestows great flexibility on companies. However, in the United States the sourcing issue has become highly politicized. At election time, candidates tap into Americans' fears and concerns over a "jobless" economic recovery. The first wave of nonmanufacturing outsourcing primarily affected **call centers**, sophisticated telephone operations that provide customer support and other services to in-bound callers from around the world; call centers also perform outbound services such as telemarketing (see Exhibit 8-8). Now, however, outsourcing is expanding and includes white-collar, high-tech service-sector jobs. Workers in low-wage countries are performing a variety of tasks including completing tax returns, processing insurance claims, performing research for financial services companies, reading medical scans and X-rays, and drawing up architectural blueprints. American companies that transfer work abroad are finding

Exhibit 8-7 Vietnam is home to dozens of state-run textile and apparel manufacturers that export $1 billion in clothing and footwear each year. The country's garment sector produces merchandise for Nike, Zara, The Limited, and other popular brands. Recently, Vietnam's National Textile-Garment Group (Vinatex) began working with Western consultants to transform the structure and culture of its affiliated companies.
Source: Richard Vogel/Associated Press.

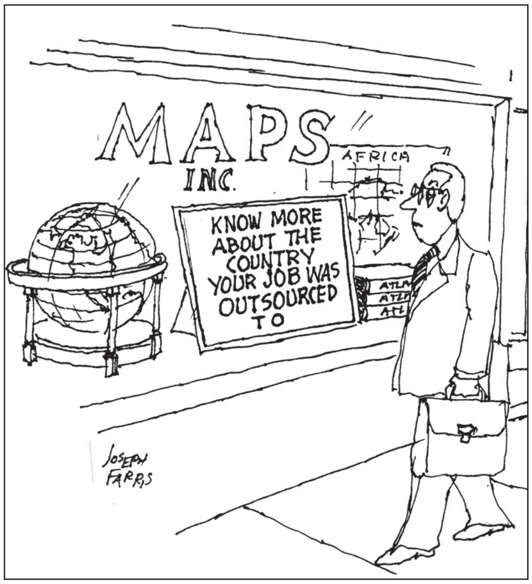
Exhibit 8-8 In Mumbai, India, and other locations, call centers such as this one specialize in "long-distance" or "arm's-length" services. India's well-educated workforce and the growing availability of broadband Internet connections mean that more Western service jobs and industries are subject to global outsourcing. Among the tasks being outsourced to India are medical record transcription, tax return preparation, and technical writing. In fact, the book you are reading was typeset in Chennai, Tamil Nadu, India.
Source: David Pearson/Alamy Stock Photo.

TABLE 8-7 Top 30 Country Destinations for Outsourcing

Region	Countries
Americas	Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Panama, Peru
Asia-Pacific	Bangladesh, China, India, Indonesia, Malaysia, Philippines, Sri Lanka, Thailand, Vietnam
Europe, Middle East, and Africa	Bulgaria, Czech Republic, Egypt, Hungary, Mauritius, Morocco, Poland, Romania, Russia, Slovakia, South Africa, Turkey, Ukraine

themselves in the spotlight. Table 8-7 lists the top 30 country destinations for global outsourcing, as determined by the Gartner Group.

As this discussion suggests, the decision of where to locate key business activities depends on factors besides cost. There are no simple rules to guide sourcing decisions. Thus the sourcing decision is one of the most complex and important decisions faced by a global company. Several factors may figure into the sourcing decision: management vision, factor costs and conditions, customer needs, public opinion, logistics, country infrastructure, the political environment, and exchange rates.



Source: Cartoon Features Syndicate.

Management Vision

Some chief executives are determined to retain some or all manufacturing in their home country. The late Nicolas Hayek was one such executive. When he was head of the Swatch Group, Hayek presided over the spectacular revitalization of the Swiss watch industry. The Swatch Group's portfolio of brands includes Blancpain, Omega, Breguet, Rado, and, of course, the inexpensive Swatch brand itself. Hayek demonstrated that the fantasy and imagination of childhood and youth could be translated into breakthroughs that allow mass-market products to be manufactured in high-wage countries side by side with handcrafted luxury products. The Swatch story is a triumph of engineering, as well as a triumph of the imagination. The challenge going forward: winning the business of customers—especially young ones—who do not believe that they need to own a traditional timepiece (see Exhibit 8-9).[14]

Similarly, top management at Canon has chosen to maintain a strategic focus on high-value-added products rather than manufacturing location. The company aims to keep 60 percent of its manufacturing at home in Japan. The company offers a full line of office equipment, including popular products such as printers and copiers; it is also one of the top producers of digital cameras. Instead of increasing the level of automation in its Japanese factories, the company has transitioned from assembly lines to so-called cell production.[15]

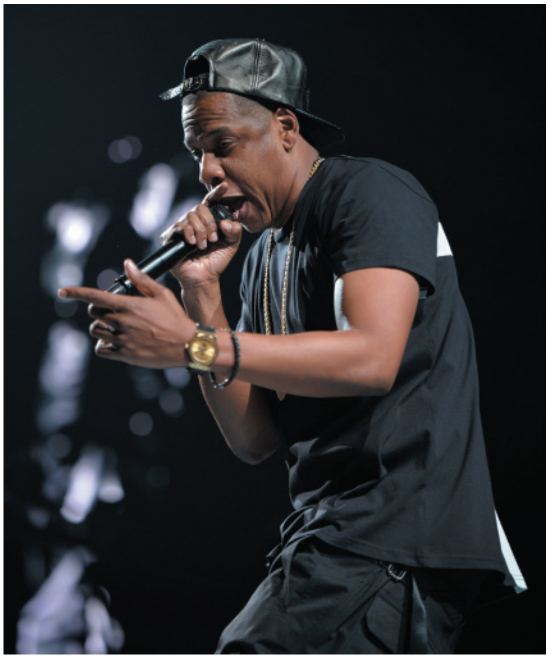


Exhibit 8-9 Jay-Z is a brand ambassador for Swiss watchmaker Hublot. Hublot's limited-edition watch, Shawn Carter by Hublot, was available in black ($17,900) and yellow gold ($33,900). A total of 350 were made; all were sold.
Source: Paul Martinka/Polaris/Newscom.

Factor Costs and Conditions

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

"Twenty years ago we were in the process of moving every appliance manufacturing job to China or Mexico. But when I open up the safe under my desk I can't find the pennies that we have saved. . . . So the next generation of products are going to be made in the U.S."[16]

Jeff Immelt, former CEO, General Electric

Volkswagen's business environment includes a significant wage differential between Mexico and Germany, the strength of the euro, and growing worldwide demand for compact and subcompact vehicles. Taken together, these factors dictate a Mexican manufacturing facility that builds models destined for the United States, China, Europe, and other key markets. Assembly-line wages for Mexican workers start at about $40 per day; by contrast, German auto workers average $60 per hour in pay and benefits. Volkswagen has invested $1 billion to design and produce the next-generation Jetta at a sprawling plant in Mexico City. Next up: The company will build a $1.3 billion plant to produce its popular Audi Q5 SUV. Volkswagen, Honda, Nissan, and other global automakers also benefit from the fact that Mexico has 45 free trade agreements (FTAs) with North America, Europe, Japan, and most of the countries of South America. These FTAs cut the costs of importing components as well as exporting finished vehicles. In addition, Mexico's car industry is now well developed and the labor pool is highly skilled and productive.[17]

Do lower wage rates demand that a company relocate 100 percent of its manufacturing to low-wage countries? Not necessarily. During his tenure as chairman at Volkswagen, Ferdinand Piech improved his company's competitiveness by convincing unions to accept flexible work schedules. For example, during peak demand, employees work 6-day weeks; when demand slows, factories produce cars only 3 days per week. Labor costs in nonmanufacturing jobs are also dramatically lower in some parts of the world. For example, a software engineer in India may receive an annual salary of $12,000; by contrast, an American with the same education and experience might earn $80,000.

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

The application of advanced computer controls and other new manufacturing technologies has reduced the proportion of labor relative to capital for many businesses. In formulating a sourcing strategy, company managers and executives should also recognize the declining importance of direct manufacturing labor as a percentage of total product cost. It is certainly true that, for many companies in high-wage countries, the availability of cheap labor is a prime consideration when choosing manufacturing locations; this is why China has become "the world's workplace." However, it is also true that direct labor cost may be a relatively small percentage of the total production cost. As a result, it may not be worthwhile to incur the costs and risks of establishing a manufacturing activity in a distant location.

Customer Needs

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

Logistics

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

"Supply Chain 101 says the most important thing is continuity of supply. When you establish a supply line that is 12,000 miles long, you have to weigh the costs of additional inventory and logistics costs versus what you can save in terms of lower costs per unit or labor costs."[18]

Norbert Ore, Institute for Supply Management

Despite these overall trends, a number of specific issues pertaining to logistics can affect the sourcing decision. For example, since the 2001 terrorist attacks, importers have been required to send electronic lists of cargo to the U.S. government prior to shipping goods to the United States. The goal is to help the U.S. Customs Service identify high-risk cargo that could be linked to the global terror network. In 2014, a work slowdown at West Coast ports cost the U.S. economy an estimated $2 billion per day. Such incidents can delay shipments by weeks or even months.

Country Infrastructure

To present an attractive setting for a manufacturing operation, it is important that a country's infrastructure be sufficiently developed to support manufacturing and distribution. Infrastructure requirements will vary by company and by industry, but, at a minimum, they will include power, transportation and roads, communications, service and component suppliers, a labor pool, civil order, and effective governance. In addition, companies must have reliable access to foreign exchange for the purchase of necessary materials and components from abroad. Additional requirements include a physically secure setting where work can be done and from which products can be shipped.

A country may have cheap labor, but does it have the necessary supporting services or infrastructure to support a high volume of business activities? Many countries offer these conditions, including Hong Kong, Taiwan, and Singapore. In scores of other low-wage countries, however, the infrastructure is woefully underdeveloped. In China, a key infrastructure weakness is the "cold chain," a food industry term for temperature-controlled trucks and warehouses. According to one estimate, an investment of $100 billion will be required to modernize China's cold chain.[19] Meanwhile, the Chinese government is spending hundreds of millions of dollars on a superhighway system that will eventually connect all 31 of China's provinces. When the project is completed in 2020, China will have approximately 53,000 miles of paved expressway—more than the roads system of the United States.

Infrastructure improvement is a key issue in other emerging markets as well. In India, for example, it takes 8 days for cargo traveling by truck between Kolkata and Mumbai to make the trip of 1,340 miles![20] Likewise, one of the challenges of doing business in the new

Russian market is an infrastructure that is woefully inadequate to handle the increased volume of shipments.

Political Factors

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

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

Market access is another type of political factor. If a country or a region limits market access because of local content laws, balance of payments problems, or any other reason, it may be necessary to establish a production facility within the country itself. For instance, the Japanese automobile companies invested in U.S. plant capacity because of concerns about market access. By producing cars in the United States, they have a source of supply that is not exposed to the threat of tariff or import quotas. Market access also figured heavily in Boeing's decision to produce airplane components in China. China ordered 100 airplanes valued at $4.5 billion; in return, Boeing is making investments and transferring engineering and manufacturing expertise.[21]

Foreign Exchange Rates

"Ultimately, the best strategy is to build vehicles in the markets where we sell them."[22]

Takahiko Ijichi, senior managing director, Toyota

In deciding where to source a product or locate a manufacturing activity, managers must take into account foreign exchange rate trends in various parts of the world. Exchange rates are so volatile today that many companies pursue global sourcing strategies as a way of limiting exchange-related risk. At any point in time, what has been an attractive location for production may become much less attractive due to exchange rate fluctuation. For example, *endaka* is the Japanese term for a strong yen. In 2010, the yen strengthened to a 15-year high, trading at ¥85/$1. For every 1 yen increase relative to the American dollar, Canon's operating income declines by 6 billion yen! As noted earlier, Canon's management is counting on research-and-development investment to ensure that its products deliver superior margins that offset the strong yen. Also, Canon and other Japanese companies have become less reliant on the U.S. market as demand in emerging markets has increased.

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

Summary

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

Governments use a variety of programs to support exports, including tax incentives, subsidies, and export assistance. Governments also discourage imports with a combination of *tariffs* and *nontariff barriers*. A *quota* is one example of a nontariff barrier. Export-related policy issues include the status of *foreign sales corporations (FSCs)* in the United States, Europe's *Common Agricultural Policy (CAP)*, and *subsidies*. Governments establish *free trade zones* and *special economic zones* to encourage investment.

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

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

A number of export–import payment methods are available. A transaction begins with the issue of a *pro-forma invoice* or some other formal document. A basic payment instrument is the *letter of credit (L/C)*, which ensures payment from the buyer's bank. *Documentary collection* is option that involves using either a *sight draft* or a *time draft*. Sales may also be made using *cash with order (CWO)* and sales on open account, or a consignment agreement.

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

Discussion Questions

8-1. Briefly explain the issues of potential export problems with regards to logistics.
8-2. Describe the stages a company typically goes through as it learns about exporting.
8-3. Identify and explain the roles of some of the key participants involved in the exporting process.
8-4. What is a trade mission, and why might it be crucial in developing trade?
8-5. What are duty drawbacks, and which types of economy are likely to use them?
8-6. What is the difference between an L/C and other forms of export–import financing? Why do sellers often require L/Cs in international transactions?

CASE 8-1 *(Continued from page 267)*

The Hong Kong Trade and Investment Hub

The Hong Kong Special Administrative Region (HKSAR) has a central place in the East Asian production and distribution channels as one of the leading regional distribution centers (RDCs) together with Shanghai, Shenzhen, and Singapore. A former British territory handed over to China in 1997 but still preserving a fairly autonomous and independent economy (according to the formula "one country, two systems"), it is one of the principal export-led growth Asian economies.

Hong Kong is the world's seventh-largest trading economy as of 2017, has the highest foreign direct investment (FDI) after China, and is often the first port of call for Western companies approaching Asian markets for exporting as well as sourcing. More than anything else, it offers a very sophisticated service economy; services account for more than 90 percent in terms of contribution. Hong Kong's GDP is based on four main sectors: trading and logistics (21.5 percent of GDP in 2018), tourism (4.5 percent), financial services (18.9 percent), and professional services of various kinds (12.2 percent).

What makes Hong Kong so attractive? History aside, there are many important factors that appeal to a company when it decides to go global and enter Asian markets, which are now acknowledged as engines of world growth.

First of all, Hong Kong is a free trade zone in the sense that all products, with the exception of specific items like tobacco and spirits, enjoy zero taxes in imports and exports. This has allowed a series of advantages, such as the offshoring of manufacturing to the neighboring Guangdong province in China since the 1970s. Outputs are sent to Hong Kong for packaging, advertising, and further re-exports.

A rapid look at the Hong Kong Trade and Development Centre's trade statistics will show that the majority of the HK SAR's exports actually comprise re-exports of imported products from China and abroad. Hong Kong's total exports were about $533.1 billion in 2018, while re-exports accounted for $527.2 billion. China, unsurprisingly, is the main supplier of imports, but many countries benefit from the free-trade regime. In the case of China, this relationship has become easier since the Closer Economic Partnership Arrangement (CEPA). This treaty, signed in 2004 (and the first of its kind to be signed between the two entities), is now a building block of the progressively closer integration of Hong Kong's economy with the Chinese mainland, not only in the traditional manufacturing and logistics sectors but also in services, which are generally off-limits for foreign companies. As a result of CEPA's provisions, Hong Kong suppliers are enjoying preferential treatment when entering the mainland market in various service areas and can also have professional titles and qualifications recognized in China.

Hong Kong's infrastructure has a major role to play in its success in international trade and investments. Hong Kong as a city has an impressive network for exhibitions and conventions. It is considered one of the most efficient and organized cities in the world, with locations like the Hong Kong Convention and Exhibition Centre (HKCEC) in the main business district, the Asia World-Expo near the international airport, and the Hong Kong International Trade and Exhibition Centre in the Kowloon area. According to government statistics, the exhibition business generated nearly 77,000 jobs in 2016 and accounted for 2.1 percent of Hong Kong's GDP, which has continued to grow steadily. Almost 40,000 companies were exhibited in 2018 in one of Hong Kong's numerous trade fairs, with the number of visitors reaching 1.9 million (around one-fifth of the whole Hong Kong population); the sector also attracts high-value visitors that spend on accommodation and meals.

All these factors contribute to the creation of a very positive environment for external trade logistics, which is where Hong Kong's specialty lies. A veritable trade hub, Hong Kong is now a key component in Asian supply chains, and its deep-water port is one of the world's most competitive. It has the world's busiest airport for international cargo as of 2017 and the fifth busiest container port after Shanghai, Singapore, Shenzen and Ningbo-Zhoushan, with 20.77 million TEU[23] in 2017. Hong Kong International Airport (HKIA) at Chek Lap Kok is the busiest cargo gateway and was reportedly the eighth busiest passenger airport in the world in 2018. The deep-water port was the world's most important for container traffic from 1987 to 1989, then from 1992 to 1997, and later from 1999 to 2004, and it operates nine container terminals in three locations: Kwai Chung, Stonecutters Island, and Tsing Yi. There are many important operators here, including Modern Terminals Ltd., Hongkong International Terminals Ltd., COSCO Information & Technology (H.K.) Ltd., Dubai Port International Terminals Ltd., and Asia Container Terminals Ltd.

Many Western companies have started using Hong Kong not only as a hub but also as a location to showcase brands that will be sold later in Chinese markets (especially in fashion). Hong Kong is a city of references for mainland customers, who increasingly visit the SAR for shopping sprees. More than 58.4 million visitors were recorded in 2017, with Mainland Chinese accounting for 44.4 million of the total.

Nevertheless, challenges await Hong Kong. The SAR is a late starter compared to, say, Singapore or Taiwan, when it comes to trade partnerships, which are progressively becoming a fundamental tool in international trade. Hong Kong has seven free trade associations: Mainland China (June 2003), New Zealand (March 2010), the European Free Trade Association (EFTA) (June 2011), Chile (September 2012), Macao (October 2017), the Association of Southeast Asia Nations (ASEAN) (November 2017), and Georgia (June 2018). It has also finished FTA negotiations with Maldives and Australia. The partnership with the ASEAN bloc is only in its inception. Furthermore, given its free port status, Hong Kong has less to offer in terms of tariff cuts. However, because of its privileged status with China and its strengths in financial and legal services, odds are that the Hong Kong SAR will maintain its position as one of the world's leading trading economies.

Discussion Questions

8-7. What are the elements that make Hong Kong so successful in terms of external trade?

8-8. Analyze the role of the exhibition industry in Hong Kong.

8-9. Using the sources provided as well as online research, illustrate the main features of Hong Kong as a logistics hub, especially regarding its deep-water port.

8-10. Why are Western companies increasingly using Hong Kong to showcase their products?

8-11. What are the main challenges awaiting Hong Kong in its efforts to remain one of the world's largest trading economies?

Sources: Hong Kong Trade and Development Centre, research.hktdc.com; CEPA Partnership Agreement, www.tid.gov.hk/english/cepa/cepa_overview.html; World Bank Statistics on Container Port Traffics in TEU Statistics, data.worldbank.org/indicator/IS.SHP.GOOD.TU; Hong Kong International Airport, www.hongkongairport.com/eng/index.html.

CASE 8-2
Turkish Cars: The Big Picture

Over the last few years, the automotive sector has become Turkey's leading source of exports, accounting for $31 billion, or 15 percent, of Turkey's total export revenue. Over the last decade, the market has been dominated by four main producers, representing 85 percent of the production: Ford Otosan, Oyak-Renault, and Tofas-Fiat, which are partnerships between Turkish and foreign car makers, and Toyota, which is wholly owned by Japan. In 2017, Turkey was estimated to be the 14th largest producer worldwide, having earned that rank by exporting 83.3 percent of its total production. Foreign direct investment has been the main means of entry into the sector. Between 2000 and 2017, original equipment manufacturers invested $14 billion in Turkey.

Turkey became the fifth largest producer in Europe by the end of 2017. However, there is yet to be an automotive brand completely owned by a Turkish company. While Turkey aims to produce and develop a local brand by 2023, sourcing all the components and technologies from within the country is highly unlikely despite the availability of technological infrastructure (research and development centers and high-level universities) and accumulation of skills owing to a globalized economy and the role of automotive imports. It should be noted, however, that there are no brands in this sector with absolute local sourcing within the country of production. As such, it may not be a drawback for Turkey to not have its own car brand; it has instead been opting to encourage further cooperation with major global manufacturers, with particular focus on electric batteries and design development, and to develop a brand that imports some of the required components. Automobile ownership per capita over the last decade has increased considerably in Turkey, with a current level of 142 cars per 1,000 people compared to ownership in France and Germany, where there were approximately 479 and 555 cars per 1,000 people, respectively, in 2017.

Yet there are several challenges worldwide that keep Turkey from achieving its annual export target. A recession in the global economy since 2008 has negatively affected external demand. The decreasing value of the Turkish lira against the euro and the dollar adversely affected the sector and exporters, as other currencies also lost against the dollar (especially in emerging markets). Interestingly, the change in exchange rates causes imported input prices to rise, thereby increasing export prices. Moreover, foreign luxury carmakers like BMW, Audi, VW, Mercedes, Jaguar Land Rover, and Porsche reap huge profits by selling luxury cars in Turkey despite heavy import taxes. In addition, import prices of car parts and raw material (such as steel and energy) along with the luxury car sector (comprising vehicles not made in Turkey) are canceling out the positive effects of car exports on the balance of payment. In 2012, incentives were introduced by the Ministry of Economy for the automobile sector to become a global player by 2023. In a bid to raise the sector's annual exports to $75 billion (from $21.5 billion in 2014) over the next decade, Turkey began offering tax breaks of up to 60 percent and incentives like deductions on employee costs in the hopes of attracting investment in the automotive sector. In the same year, however, a hike in the special consumption tax (SCT) from 84 percent to 130 percent on engines of two liters and over took the sector by surprise. Reacting to the rise in the SCT and the global financial crisis, local automotive sales dropped from the beginning of 2012, with an annual market contraction estimated at around 15 percent year-on-year. Additionally, other factors must be considered: (a) although consumer loan applications (car credit) have not decreased much, the number of approved requests has as banks are more selective now, and (b) inflation and hikes in unemployment were also noted in many reports as reasons for falling purchases.

Looking ahead, Turkey's automotive sector is expected to heavily depend on exports of finished products and imports of components and technological knowhow. With Europe slowly recovering from the 2008 economic crisis, a moderate rise in demand is expected. Domestically, as indicated above, the number of cars per 1,000 residents is still low, allowing production to be redirected toward the home market, depending on credit and general economic conditions. Turkey manufactured 1.55 million vehicles and exported more than 1.3 million vehicles in 2018. Looking forward, there is a continued downward pressure on the production front largely due to the high increases in production over the past few years. It is expected that production will remain flat for two or three years. Exports continue to be an important part of the equation. The value of the euro against the dollar is a significant factor; higher exchange rates lower demand for imported cars in Turkey and increase demand for domestically produced vehicles. Government-sponsored scrappage schemes have also been effective. The government has also offered incentives on hybrid and diesel engine investments. A new prototype is expected to be introduced by 2019 to go into production in 2021.

This case demonstrates the importance of having a good understanding of country-specific factors, macro-factors, local legislation, and political strategy while dealing with international businesses. Working in the automotive sector in Turkey entails operating on an international level on a daily basis while dealing with both internal and external changes in the ecosystem. When working in the transportation industry, it is easy to forget the big picture. Although the process may seem overwhelming—with specific jargon such as container load (CL), rate request, transit times, hazardous declarations, estimated time of departure (ETD) and estimated time of arrival (ETA), storage/disposal charges, letter of credit, shippers export declaration (SED), and bill of lading (B/L)—together with an array of agents—from vessel operating common carrier to local customs, trade associations and part suppliers networks—it is important to remember the counterintuitive factors that enhance or hinder import/export potentials.

Discussion Questions

8-12. Based on the complexities and challenges discussed in the case, what industry knowledge and skills are required to be successful as an export coordinator, especially in the automotive sector?

8-13. What do you think is the hardest type of macro-environmental factor to obtain? How can you keep it up to date?

8-14. If you were working in the automotive industry in Turkey, what would your next move be?

Notes

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

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[22]Jonathan Soble and Lindsay Whipp, "Yen's March Spoils the Party for Japan's Exporters," *Financial Times* (August 10, 2010), p. 14.

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9 Global Market-Entry Strategies: Licensing, Investment, and Strategic Alliances

LEARNING OBJECTIVES

9-1 Explain the advantages and disadvantages of using licensing as a market-entry strategy.

9-2 Compare and contrast the different forms that a company's foreign investments can take.

9-3 Discuss the factors that contribute to the successful launch of a global strategic partnership.

9-4 Identify some of the challenges associated with partnerships in developing countries.

9-5 Describe the special forms of cooperative strategies found in Asia.

9-6 Explain the evolution of cooperative strategies in the twenty-first century.

9-7 Use the market expansion strategies matrix to explain the strategies used by the world's biggest global companies.

CASE 9-1

AB InBev and SABMiller: A Match Made in (Beer) Heaven?

South African Breweries (SAB) PLC had a problem. The company owned more than 100 breweries in 24 countries. South Africa, where SAB had a commanding 98 percent share of the beer market, accounted for approximately 14 percent of annual revenues. However, most of its brands, which include Castle Lager, Pilsner Urquell, and Carling Black Label, were sold on a local or regional basis; none had the global status of, say, Heineken, Amstel, or Guinness. Nor were the company's brands well known in the key U.S. market, where a growing number of the "echo boom"—the children of the nation's 75 million Baby Boomers—were reaching drinking age.

In the early 2000s, then-CEO Graham Mackay embarked on a buying spree; over the course of 14 years, Mackay negotiated dozens of merger, acquisition, and joint-venture deals. Before long, SABMiller had operations in nearly 80 countries. For example, Mackay bought Philip Morris's Miller Brewing unit. The $3.6 billion deal created SABMiller, the world's number 2 brewer in terms of production volume; Anheuser-Busch InBev ranked first. Miller operates nine breweries in the United States, where