

## 6.3: What is Importing and Exporting?

### Learning Objectives

1. Understand what importing and exporting are.
2. Learn why companies export.
3. Explain the main contractual and investment entry modes.

### What Do We Mean by Exporting and Importing?

The history of importing and exporting dates back to the Roman Empire, when European and Asian traders imported and exported goods across the vast lands of Eurasia. Trading along the **Silk Road** flourished during the thirteenth and fourteenth centuries. Jack Goldstone, *Why Europe? The Rise of the West in World History 1500–1850* (New York: McGraw-Hill, 2008). Caravans laden with imports from China and India came over the desert to Constantinople and Alexandria. From there, Italian ships transported the goods to European ports. J. O. Swahn, *The Lore of Spices* (Gothenburg, Sweden: Nordbok, 1991), 15–17.

For centuries, importing and exporting has often involved intermediaries, due in part to the long distances traveled and different native languages spoken. The spice trade of the 1400s was no exception. Spices were very much in demand because Europeans had no refrigeration, which meant they had to preserve meat using large amounts of salt or risk eating half-rotten flesh. Spices disguised the otherwise poor flavor of the meat. Europeans also used spices as medicines. The European demand for spices gave rise to the spice trade. Antony Wild, *The East India Company: Trade and Conquest from 1600* (Guilford, CT: Lyons Press, 2000). The trouble was that spices were difficult to obtain because they grew in jungles half a world away from Europe. The overland journey to the spice-rich lands was arduous and involved many middlemen along the way. Each middleman charged a fee and thus raised the price of the spice at each point. By the end of the journey, the price of the spice was inflated 1,000 percent. Jack Turner, *Spice: The History of a Temptation* (Westminster, MD: Alfred A. Knopf, 2004), 5.

As explained in Chapter 8, **exporting** is defined as the sale of products and services in foreign countries that are sourced or made in the home country. Importing is the flipside of exporting. **Importing** refers to buying goods and services from foreign sources and bringing them back into the home country. Importing is also known as global sourcing, which will be examined in depth in [Section 9.4](#).

### An Entrepreneur's Import Success Story

Selena Cuffe started her wine import company, Heritage Link Brands, in 2005. Importing wine isn't new, but Cuffe did it with a twist: she focused on importing wine produced by black South Africans. Cuffe got the idea after attending a wine festival in Soweto, where she saw more than five hundred wines from eighty-six producers showcased. Selena Cuffe's bio, African-American Chamber of Greater Cincinnati / Greater Kentucky, accessed September 4, 2010, [african-americanchamber.com/view-user-profile/selena-cuffe.html](http://african-americanchamber.com/view-user-profile/selena-cuffe.html). Cuffe did some market research and learned of the \$3 billion wine industry in Africa. She also saw a gap in the existing market related to wine produced by indigenous African vintners and decided to fill it. She started her company with \$70,000, financed through her savings and credit cards. (In [Section 9.5](#), you'll learn about other sources of financing available to entrepreneurs and small businesses as well as to larger enterprises.) In the first year, sales were only \$100,000 but then jumped to \$1 million in the second year, when Cuffe sold to more than one thousand restaurants, retailers, and grocery stores. South African Chamber of Commerce in America, "Heritage Link Brands, Connecting U.S. Palates to African Wines," profile, May 4, 2010, accessed September 4, 2010, [www.sacca.biz/?m=5&idkey=637](http://www.sacca.biz/?m=5&idkey=637). Even better, American Airlines began carrying Cuffe's imported wines on flights, thus providing a steady flow of business amid the more uncertain restaurant market. American Airlines, "Serving Up Wines That Invest in Our Communities," American Airlines Corporate Responsibility page, accessed September 4, 2010, [www.aa.com/i18n/aboutUs/corporateResponsibility/caseLibrary/supporting-our-communities.jsp](http://www.aa.com/i18n/aboutUs/corporateResponsibility/caseLibrary/supporting-our-communities.jsp). Cuffe has attributed her success to passion as well as to patience for meeting the multiple regulations required when running an import business. Maritza Manresa, *How to Open and Operate a Financially Successful Import Export Business* (Ocala, FL: Atlantic Publishing, 2010), 101. (You'll learn more about these regulations in [Section 9.4](#)).

Exporting is an effective entry strategy for companies that are just beginning to enter a new foreign market. It's a low-cost, low-risk option compared to the other strategies. These same reasons make exporting a good strategy for small and midsize companies that can't or won't make significant financial investment in the international market.

Companies can sell into a foreign country either through a local distributor or through their own salespeople. Many government export-trade offices can help a company find a local distributor. Increasingly, the Internet has provided a more efficient way for foreign companies to find local distributors and enter into commercial transactions.

**Distributors** are export intermediaries who represent the company in the foreign market. Often, distributors represent many companies, acting as the “face” of the company in that country, selling products, providing customer service, and receiving payments. In many cases, the distributors take title to the goods and then resell them. Companies use distributors because distributors know the local market and are a cost-effective way to enter that market.

However, using distributors to help with export can have its own challenges. For example, some companies find that if they have a dedicated salesperson who travels frequently to the country, they’re likely to get more sales than by relying solely on the distributor. Often, that’s because distributors sell multiple products and sometimes even competing ones. Making sure that the distributor favors one firm’s product over another product can be hard to monitor. In countries like China, some companies find that—culturally—Chinese consumers may be more likely to buy a product from a foreign company than from a local distributor, particularly in the case of a complicated, high-tech product. Simply put, the Chinese are more likely to trust that the overseas salesperson knows their product better.

## Why Do Companies Export?

Companies export because it’s the easiest way to participate in global trade, it’s a less costly investment than the other entry strategies, and it’s much easier to simply stop exporting than it is to extricate oneself from the other entry modes. An export partner in the form of either a distributor or an export management company can facilitate this process. An **export management company (EMC)** is an independent company that performs the duties that a firm’s own export department would execute. The EMC handles the necessary documentation, finds buyers for the export, and takes title of the goods for direct export. In return, the EMC charges a fee or commission for its services. Because an EMC performs all the functions that a firm’s export department would, the firm doesn’t have to develop these internal capabilities. Most of all, exporting gives a company quick access to new markets.

## Benefits of Exporting: Vitrac

Egyptian company Vitrac was founded by Mounir Fakhry Abdel Nour to take advantage of Egypt’s surplus fruit products. At its inception, Vitrac sourced local fruit, made it into jam, and exported it worldwide. Vitrac has acquired money, market, and manufacturing advantages from exporting: Japan External Trade Organization, “Big in Japan,” case study, accessed August 27, 2010, [www.jetro.go.jp/en/reports/](http://www.jetro.go.jp/en/reports/).

- **Market.** The company has access to a new market, which has brought added revenues.
- **Money.** Not only has Vitrac earned more revenue, but it has also gained access to foreign currency, which benefits companies located in certain regions of the world, such as in Vitrac’s home country of Egypt.
- **Manufacturing.** The cost to manufacture a given unit decreased because Vitrac has been able to manufacture at higher volumes and buy source materials in higher volumes, thus benefitting from volume discounts.

## Risks of Exporting

There are risks in relying on the export option. If you merely export to a country, the distributor or buyer might switch to or at least threaten to switch to a cheaper supplier in order to get a better price. Or someone might start making the product locally and take the market from you. Also, local buyers sometimes believe that a company which only exports to them isn’t very committed to providing long-term service and support once a sale is complete. Thus, they may prefer to buy from someone who’s producing directly within the country. At this point, many companies begin to reconsider having a local presence, which moves them toward one of the other entry options.

## Ethics in Action

Different Countries, Different Food and Drug Rules

Particular products, especially foods and drugs, are often subject to local laws regarding safety, purity, packaging, labeling, and so on. Companies that want to make a product that can be sold in multiple countries will have to comply with the highest common denominator of all the laws of all the target markets. Complying with the highest standard could increase the overall cost of the product. As a result, some companies opt to stay out of markets where compliance with the regulation would be more costly. Is it ethical to be selling a product in one country that another country deems substandard?

## Specialized Entry Modes: Contractual

Exporting is a easy way to enter an international market. In addition to exporting, companies can choose to pursue more specialized modes of entry—namely, contractual modes or investment modes. Contractual modes involve the use of contracts rather than investment. Let's look at the two main contractual entry modes, licensing and franchising.

### Licensing

**Licensing** is defined as the granting of permission by the licensor to the licensee to use intellectual property rights, such as trademarks, patents, brand names, or technology, under defined conditions. The possibility of licensing makes for a flatter world, because it creates a legal vehicle for taking a product or service delivered in one country and providing a nearly identical version of that product or service in another country. Under a licensing agreement, the multinational firm grants rights on its intangible property to a foreign company for a specified period of time. The licensor is normally paid a royalty on each unit produced and sold. Although the multinational firm usually has no ownership interests, it often provides ongoing support and advice. Most companies consider this market-entry option of licensing to be a low-risk option because there's typically no up-front investment.

For a multinational firm, the advantage of licensing is that the company's products will be manufactured and made available for sale in the foreign country (or countries) where the product or service is licensed. The multinational firm doesn't have to expend its own resources to manufacture, market, or distribute the goods. This low cost, of course, is coupled with lower potential returns, because the revenues are shared between the parties.

### Franchising

Similar to a licensing agreement, under a **franchising** agreement, the multinational firm grants rights on its intangible property, like technology or a brand name, to a foreign company for a specified period of time and receives a royalty in return. The difference is that the franchiser provides a bundle of services and products to the franchisee. For example, McDonald's expands overseas through franchises. Each franchise pays McDonald's a franchisee fee and a percentage of its sales and is required to purchase certain products from the franchiser. In return, the franchisee gets access to all of McDonald's products, systems, services, and management expertise.

## Specialized Entry Modes: Investment

Beyond contractual relationships, firms can also enter a foreign market through one of two investment strategies: a joint venture or a wholly owned subsidiary.

### Joint Ventures

An **equity joint venture** is a contractual, strategic partnership between two or more separate business entities to pursue a business opportunity together. The partners in an equity joint venture each contribute capital and resources in exchange for an equity stake and share in any resulting profits. (In a nonentity joint venture, there is no contribution of capital to form a new entity.)

To see how an equity joint venture works, let's return to the example of Egyptian company, Vitrac. Mounir Fakhry Abdel Nour founded his jam company to take advantage of Egypt's surplus fruit products. Abdel Nour initially approached the French jam company, Vitrac, to enter into a joint venture with his newly founded company, VitracEgypt. Abdel Nour supplied the fruit and the markets, while his French partner supplied the technology and know-how for producing jams.

In addition to exporting to Australia, the United States, and the Middle East, Vitrac began exporting to Japan. Sales results from Japan indicated a high demand for blueberry jam. To meet this demand—in an interesting twist, given Vitrac's origin—Vitrac had to import blueberries from Canada. Vitrac thus was importing blueberries from Canada, manufacturing the jam in Egypt, and exporting it to Japan. Japan External Trade Organization, "Big in Japan," case study, accessed August 27, 2010, [www.jetro.go.jp/en/reports/](http://www.jetro.go.jp/en/reports/).

Using French Vitrac's manufacturing know-how, Abdel Nour had found a new supply and the opportunity to enter new markets with it, thus expanding his partner's reach. The partnership fit was good. The two companies' joint venture continued for three years, until the French company sold its shares to Abdel Nour, making Vitrac a 100 percent owned and operated Egyptian company. Abdel Nour's company reached \$22 million in sales and was the Egyptian jam-market leader before being bought by a larger Swiss company, Hero. "Egypt/Switzerland: Hero Acquires Egyptian Jam Market Leader," *Just-Food*, October 8, 2002, accessed September 5, 2010, [www.just-food.com/news/hero-acquires-egyptian-jam-market-leader\\_id69297.aspx](http://www.just-food.com/news/hero-acquires-egyptian-jam-market-leader_id69297.aspx).

## Risks of Joint Ventures

Equity joint ventures pose both opportunities and challenges for the companies involved. First and foremost is the challenge of finding the right partner—not just in terms of business focus but also in terms of compatible cultural perspectives and management practices.

Second, the local partner may gain the know-how to produce its own competitive product or service to rival the multinational firm. This is what's currently happening in China. To manufacture cars in China, non-Chinese companies must set up joint ventures with Chinese automakers and share technology with them. Once the contract ends, however, the local company may take the knowledge it gained from the joint venture to compete with its former partner. For example, Shanghai Automotive Industry (Group) Corporation, which worked with General Motors (GM) to build Chevrolets, has plans to increase sales of its own vehicles tenfold to 300,000 in five years and to compete directly with its former partner. Ian Rowley, "Chinese Carmakers Are Gaining at Home," *BusinessWeek*, June 8, 2009, 30–31.

### Did You Know?

In the past, joint ventures were the only relationship foreign companies could form with Chinese companies. In fact, prior to 1986, foreign companies could not wholly own a local subsidiary. The Chinese government began to allow equity joint ventures in 1979, which marked the beginning of the Open Door Policy, an economic liberalization initiative. The Chinese government strongly encouraged equity joint ventures as a way to gain access to the technology, capital, equipment, and know-how of foreign companies. The risk to the foreign company was that if the venture soured, the Chinese company could end up keeping all of these assets. Often, Chinese companies only contributed things like land or tax concessions that foreign companies couldn't keep if the venture ended. As of 2010, equity joint ventures between a Chinese company and a foreign partner require a minimum equity investment by the foreign partner of at least 33 to 70 percent of the equity, but there's no minimum investment set for the Chinese partner. Atma Global Knowledge Media, "Entry Models into the Chinese Market," CultureQuest 2003.

## Wholly Owned Subsidiaries

Firms may want to have a direct operating presence in the foreign country, completely under their control. To achieve this, the company can establish a new, wholly owned subsidiary (i.e., a greenfield venture) from scratch, or it can purchase an existing company in that country. Some companies purchase their resellers or early partners (as VitracEgypt did when it bought out the shares that its partner, Vitrac, owned in the equity joint venture). Other companies may purchase a local supplier for direct control of the supply. This is known as vertical integration.

Establishing or purchasing a wholly owned subsidiary requires the highest commitment on the part of the international firm, because the firm must assume all of the risk—financial, currency, economic, and political.

### Did You Know?

McDonald's has a plant in Italy that supplies all the buns for McDonald's restaurants in Italy, Greece, and Malta. International sales has accounted for as much as 60 percent of McDonald's annual revenue. Annual revenue in 2008 was \$23.5 billion, of which 60 percent was international. See Suzanne Kapner, "Making Dough," *Fortune*, August 17, 2009, 14.

## Cautions When Purchasing an Existing Foreign Enterprise

As we've seen, some companies opt to purchase an existing company in the foreign country outright as a way to get into a foreign market quickly. When making an acquisition, due diligence is important—not only on the financial side but also on the side of the country's culture and business practices. The annual disposable income in Russia, for example, exceeds that of all the other BRIC countries (i.e., Brazil, India, and China). For many major companies, Russia is too big and too rich to ignore as a market. However, Russia also has a reputation for corruption and red tape that even its highest-ranking officials admit. Presidential economic advisor Arkady Dvorkovich (whose office in the Kremlin was once occupied by Soviet leader Leonid Brezhnev), for example, advises, "Investors should choose wisely" which regions of Russia they locate their business in, warning that some areas are more corrupt than others. Carol Matlack, "The Peril and Promise of Investing in Russia," *BusinessWeek*, October 5, 2009, 48–51. Corruption makes the world less flat precisely because it undermines the viability of legal vehicles, such as licensing, which otherwise lead to a flatter world.

The culture of corruption is even embedded into some Russian company structures. In the 1990s, laws inadvertently encouraged Russian firms to establish legal headquarters in offshore tax havens, like Cyprus. A **tax haven** is a country that has very advantageous (low) corporate income taxes.

Businesses registered in these offshore tax havens to avoid certain Russian taxes. Even though companies could obtain a refund on these taxes from the Russian government, “the procedure is so complicated you never actually get a refund,” said Andrey Pozdnyakov, cofounder of Siberian-based ElecCard. Carol Matlack, “The Peril and Promise of Investing in Russia,” *BusinessWeek*, October 5, 2009, 48–51.

This offshore registration, unfortunately, is a danger sign to potential investors like Intel. “We can’t invest in companies that have even a slight shadow,” said Intel’s Moscow-based regional director Dmitry Konash about the complex structure predicament. Carol Matlack, “The Peril and Promise of Investing in Russia,” *BusinessWeek*, October 5, 2009, 48–51.

### Did You Know?

Some foreign companies believe that owning their own operations in China is an easier option than having to deal with a Chinese partner. For example, many foreign companies still fear that their Chinese partners will learn too much from them and become competitors. However, in most cases, the Chinese partner knows the local culture—both that of the customers and workers—and is better equipped to deal with Chinese bureaucracy and regulations. In addition, even wholly owned subsidiaries can’t be totally independent of Chinese firms, on whom they might have to rely for raw materials and shipping as well as maintenance of government contracts and distribution channels.

Collaborations offer different kinds of opportunities and challenges than self-handling Chinese operations. For most companies, the local nuances of the Chinese market make some form of collaboration desirable. The companies that opt to self-handle their Chinese operations tend to be very large and/or have a proprietary technology base, such as high-tech or aerospace companies—for example, Boeing or Microsoft. Even then, these companies tend to hire senior Chinese managers and consultants to facilitate their market entry and then help manage their expansion. Nevertheless, navigating the local Chinese bureaucracy is tough, even for the most-experienced companies.

Let’s take a deeper look at one company’s entry path and its wholly owned subsidiary in China. Embraer is the largest aircraft maker in Brazil and one of the largest in the world. Embraer chose to enter China as its first foreign market, using the joint-venture entry mode. In 2003, Embraer and the Aviation Industry Corporation of China jointly started the Harbin Embraer Aircraft Industry. A year later, Harbin Embraer began manufacturing aircraft.

In 2010, Embraer announced the opening of its first subsidiary in China. The subsidiary, called Embraer China Aircraft Technical Services Co. Ltd., will provide logistics and spare-parts sales, as well as consulting services regarding technical issues and flight operations, for Embraer aircraft in China (both for existing aircraft and those on order). Embraer will invest \$18 million into the subsidiary with a goal of strengthening its local customer support, given the steady growth of its business in China.

Guan Dongyuan, president of Embraer China and CEO of the subsidiary, said the establishment of Embraer China Aircraft Technical Services demonstrates the company’s “long-term commitment and confidence in the growing Chinese aviation market.” United Press International, “Brazil’s Embraer Expands Aircraft Business into China,” July 7, 2010, accessed August 27, 2010, [http://www.upi.com/Business\\_News/2010/07/07/Brazils-Embraer-expands-aircraft-business-into-China/UPI-10511278532701](http://www.upi.com/Business_News/2010/07/07/Brazils-Embraer-expands-aircraft-business-into-China/UPI-10511278532701).

## Building Long-Term Relationships

Developing a good relationship with regulators in target countries helps with the long-term entry strategy. Building these relationships may include keeping people in the countries long enough to form good ties, since a deal negotiated with one person may fall apart if that person returns too quickly to headquarters.

### Did You Know?

One of the most important cultural factors in China is *guanxi* (pronounced *guan shi*), which is loosely defined as a connection based on reciprocity. Even when just meeting a new company or potential partner, it’s best to have an introduction from a common business partner, vendor, or supplier—someone the Chinese will respect. China is a relationship-based society. Relationships extend well beyond the personal side and can drive business as well. With *guanxi*, a person invests with relationships much like one would invest with capital. In a sense, it’s akin to the Western phrase “You owe me one.”

*Guanxi* can potentially be beneficial or harmful. At its best, it can help foster strong, harmonious relationships with corporate and government contacts. At its worst, it can encourage bribery and corruption. Whatever the case, companies without *guanxi* won’t accomplish much in the Chinese market. Many companies address this need by entering into the Chinese market in a collaborative arrangement with a local Chinese company. This entry option has also been a useful way to circumvent regulations governing

bribery and corruption, but it can raise ethical questions, particularly for American and Western companies that have a different cultural perspective on gift giving and bribery.

## Conclusion

In summary, when deciding which mode of entry to choose, companies should ask themselves two key questions:

1. How much of our resources are we willing to commit? The fewer the resources (i.e., money, time, and expertise) the company wants (or can afford) to devote, the better it is for the company to enter the foreign market on a contractual basis—through licensing, franchising, management contracts, or turnkey projects.
2. How much control do we wish to retain? The more control a company wants, the better off it is establishing or buying a wholly owned subsidiary or, at least, entering via a joint venture with carefully delineated responsibilities and accountabilities between the partner companies.

Regardless of which entry strategy a company chooses, several factors are always important.

- **Cultural and linguistic differences.** These affect all relationships and interactions inside the company, with customers, and with the government. Understanding the local business culture is critical to success.
- **Quality and training of local contacts and/or employees.** Evaluating skill sets and then determining if the local staff is qualified is a key factor for success.
- **Political and economic issues.** Policy can change frequently, and companies need to determine what level of investment they're willing to make, what's required to make this investment, and how much of their earnings they can repatriate.
- **Experience of the partner company.** Assessing the experience of the partner company in the market—with the product and in dealing with foreign companies—is essential in selecting the right local partner.

Companies seeking to enter a foreign market need to do the following:

- Research the foreign market thoroughly and learn about the country and its culture.
- Understand the unique business and regulatory relationships that impact their industry.
- Use the Internet to identify and communicate with appropriate foreign trade corporations in the country or with their own government's embassy in that country. Each embassy has its own trade and commercial desk. For example, the US Embassy has a foreign commercial desk with officers who assist US companies on how best to enter the local market. These resources are best for smaller companies. Larger companies, with more money and resources, usually hire top consultants to do this for them. They're also able to have a dedicated team assigned to the foreign country that can travel the country frequently for the later-stage entry strategies that involve investment.

Once a company has decided to enter the foreign market, it needs to spend some time learning about the local business culture and how to operate within it.

## KEY TAKEAWAYS

- Exporting is the sale of products and services in foreign countries that are sourced or made in the home country. Importing refers to buying goods and services from foreign sources and bringing them back into the home country.
- Companies export because it's the easiest way to participate in global trade, it's a less costly investment than the other entry strategies, and it's much easier to simply stop exporting than it is to extricate oneself from the other entry modes. The benefits of exporting include access to new markets and revenues as well as lower manufacturing costs due to higher manufacturing volumes.
- Contractual forms of entry (i.e., licensing and franchising) have lower up-front costs than investment modes do. It's also easier for the company to extricate itself from the situation if the results aren't favorable. On the other hand, investment modes (joint ventures and wholly owned subsidiaries) may bring the company higher returns and a deeper knowledge of the country.

## EXERCISES

(AACSB: Reflective Thinking, Analytical Skills)

1. What are the risks and benefits associated with exporting?
2. Name two contractual modes of entry into a foreign country. Which do you think is better and why?
3. Why would a company choose to use a contractual mode of entry rather than an investment mode?
4. What are the advantages to a company using a joint venture rather than buying or creating its own wholly owned subsidiary when entering a new international market?



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