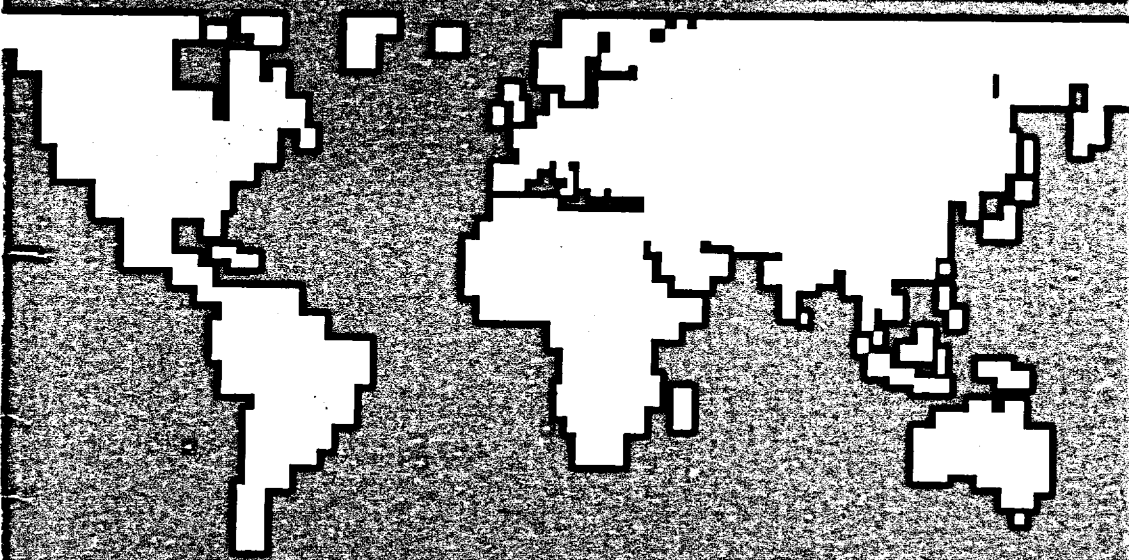
# Export Markets: The Trading House Connection



External Affairs Canada
Affaires extérieures Canada

Canada

.b 2 2860038(E)

# Export Markets:
## The Trading House Connection





Canada 1989

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# Foreword

Trading houses have received much recent attention with the release of the Trading House Task Force report, *Promoting Canadian Exports: The Trading House Option* and the formation of the Council of Canadian Trading Houses. Prior to the publication of the Task Force report, little was known in Canada about their role and function. That document, however, brought to light the significant role trading houses play in bringing the products and services of Canadian companies, particularly those of small-to-medium size, to foreign markets.

In its deliberations, the Task Force also identified areas where improvement could be made to the operating environment in Canada for trading houses. One such area was to make Canadian manufacturers and processors more aware of the services trading houses can provide, how they operate and how to select and work with trading houses. *Export Markets: The Trading House Connection* has been published with this objective in mind.

I would like to thank the trading houses that contributed in the preparation of this publication and hope that it will provide practical assistance and guidance to Canadian companies seeking to start or increase their exports through trading houses.

John C. Crosbie
Minister for International Trade

# Introduction

*The trading house sector's contribution to Canadian trade is substantial. In 1983 the export transactions of trading houses represented more than 13 per cent of total Canadian exports and more importantly 40 per cent of Canadian non-U.S. exports. Yet many manufacturing firms — both small and large — are still unaware of what trading houses can do for them. This brochure is intended to show that a judicious use of the services offered by these firms can expand sales abroad significantly.*

# *Trading Houses...What Are They?*

The trading house concept applies to a wide variety of companies with one thing in common: they serve as commercial intermediaries between Canadian-based producers and foreign-based purchasers or consumers of goods and services.

As intermediaries, they fall into two broad categories. Some act on their own account as merchants, actually buying and selling for profit and therefore taking title of the goods sold. Others act as agents on behalf of a third party, and do not take title to the goods handled but merely receive a commission or flat fee (or both) for services rendered.

Of course, in real life things seldom turn out to be quite so simple, and the line between the two categories often tends to blur. Many of Canada's trading houses function as merchants in some cases and as agents in others, depending on the type of product involved, the requirements of clients, the preference of the trading house itself, and a host of other factors.

According to a 1983 survey and contrary to popular belief, only 9 per cent of Canadian trading companies actually specialize as agents. Trading houses are often identified by the services they provide and may take any of the following forms:

- an export management company — a trading company which takes charge of all or part of the export function on behalf of a manufacturer;
- a buying house — a trading company which sources on behalf of offshore clients;
- a procurement manager — a trading company which sources for offshore projects;
- an export consortium — a trading company, owned by several producer firms, which assumes the export function on their behalf;
- an export co-operative — a trading company which manages export functions on behalf of its members; or,
- a corporate trading company — a trading company responsible for the exports of the parent company and its affiliates.

It should be noted that most trading houses are not only involved in exporting, but also in domestic distribution, importing, and third-country business (i.e., buying and selling in foreign markets).

Canadian manufacturers who wish to export, therefore, have at their disposal a wide variety of trading houses which can provide a great number of different services, including:

- market identification and selection;
- buyer identification, evaluation (including credit check), and selection;
- identification of product and packaging specifications;
- price negotiation;
- arrangement of terms of sales (including obligations of buyer and seller, terms of shipping and payment);
- financial arrangements;
- shipping arrangements;
- preparation of all export documents required;
- protection against export risks (those related to commercial and political factors, exchange rates, shipping, etc.);
- payment for goods sold and receipt of payment from foreign buyers;
- satisfaction of claims;
- provision of after-sales service; and
- promotional support abroad.

Clearly, trading houses are able to cover all aspects of export management, marketing and financing — everything that has to do with the techniques and mechanics of exporting. At one end of the spectrum, a merchant trading house may perform all the above functions, buying from the Canadian manufacturer and reselling abroad for a profit. At the other, a trading house, acting as an agent, will identify a potential client abroad for a Canadian manufacturer, and receive a commission if the transaction goes through. Between these two extremes are any number of other arrangements, depending on the needs of manufacturers and the opportunities open to trading houses.

## *Trading Houses...How Do They Operate?*

Trading house services fall under three operating modes:

- **supply marketing** where a Canadian producer of goods or services asks a trading company to find an outlet for its product abroad;
- **demand sourcing** where a foreign-based client asks a Canadian trading company to locate a supplier of specific Canadian products or services; and

- **project procurement** where a Canadian trading company submits a competitive offer of goods or services for the execution of a project abroad (from providing equipment and material for a construction project to furnishings for a hotel).

## *Supply Marketing*

Under this exporting mode, trading companies act as export management companies, export consortia, export co-operatives and corporate trading companies.

Typically, producers with temporary excess capacity will seek the help of trading companies in securing a short-term outlet for their products. These one-shot deals may interest trading companies when they can easily find a client abroad for these products.

For instance, this would be the case when:

- they are already trading similar products;
- the Canadian producers are competitive in quality and price;
- the producers have a good reputation and the trading companies would be interested in representing them;
- they have received overseas requests for products they may not yet have marketed abroad and they are interested in entering that particular product line.

In sum, trading companies will follow up on these short-term deals only if they offer opportunities for profit.

Trading companies, however, prefer to focus on long-term commitments with Canadian producers, since selling abroad is such a costly effort. This is the core of supply marketing.

### *Canadian Vacuums Clean Up in Saudi Arabia*

Canada's leading built-in cleaner systems have been keeping Saudi Arabian houses, hospitals and businesses clean and dust free since 1977 and more are on the way. Over a quarter of a million dollars' worth of Canadian-made Beam vacuum cleaner systems are now being shipped to Saudi Arabia by Overseas Projects Corporation of Canada Limited, an Ottawa-based trading company.

Dieter Hollweck, president of Overseas Projects, has been working with Saudi Arabian businesspersons since 1977 and attributes much of the company's success to experience.

The Saudi partner for the sale of Beam Canada vacuum cleaner systems is Abdullah Al-Moajil, a member of one of the country's leading trading families. Mr. Al-Moajil is giving the Canadian product a major marketing launch which includes street signs, full-page advertising in leading Saudi newspapers, plus exhibits in the largest building exhibitions and home shows in the Middle East.

*Source: Release, Overseas Projects Corporations of Canada Limited, 1987.*

This story captures the essence of supply marketing. A manufacturer approaches a trading company not merely to "sell" abroad on occasion but rather to develop a lasting presence in foreign markets. The challenge offered to the trading company has a broad focus which includes the following facets:

- finding, selecting and evaluating potential clients;
- identifying their needs and product adaptation requirements;
- mastering their business customs, building an atmosphere of trust and respect;
- developing a market entry strategy together with distribution support and promotion.

Overseas Projects and Beam Canada have both profited from their partnership. In return for the rights to market Beam products, Overseas Projects supplied experience, foreign contacts, market knowledge and seed money for development. It adapted Beam products to meet foreign market demands and then designed and implemented a complete marketing campaign and distribution system at minimal cost to the manufacturer.

This arrangement allowed Beam Canada to gain major export sales while keeping its own capital intact for much needed development in Canada. A significant portion of Beam products are now being sold abroad by Overseas Projects — a major international contribution by a trading company to a Canadian supplier.

## *Demand Sourcing*

Under the supply marketing mode, trading companies respond to requests originating with Canadian-based producers; in demand sourcing they respond to demands for Canadian products from foreign-based clients. Buying houses that source on behalf of offshore clients, and export management companies that respond to requests from foreign clients, both operate under the demand sourcing mode.

### *Wheelbarrows for Trinidad*

The following is a telephone conversation between Naim Moses, a businessman from Trinidad, and Mr. E. Kampouris, president of Béthune Import-Export Limitée, a Montreal-based trading company:

Hello, Naim! What can I do for you today?...You want wheelbarrows? Since when are you in the wheelbarrow business?

It's not for you. Who is it for?...Your brother-in-law....He's a contractor....What kind of wheelbarrows? Tell me a little bit more. I don't know much about wheelbarrows....He's got a contract, a road building contract. So, it's industrial barrows. What kind of specifications?

You already had an offer from Denmark. What kind of an offer? ...Capacity: 100 litres or more .... Comes down to four cubic feet or more. Gauge? 1.5 mm.

How many do you need?...400. Delivery? Immediate.

Any repeat order?...He will want another 200 in September.

Why doesn't he take all 600 now? It means we may get a better deal.

He doesn't want to put up so much cash at one time....Yes, but we could take care of that.

*(continued)*

What kind of price are the Danes giving you?...$31.00 (US).

Delivered where?...Trinidad, insured.

How do you pay them?...Letter of credit.

When do you want an answer?...I'll try to get something by tomorrow or the day after. Is that O.K.?...You hold on to that. Thanks!

What Mr. Kampouris now has to do is either locate a supplier or contact one he already deals with and make sure that the product can be delivered quickly and on terms acceptable to both buyer and supplier.

This is an example of a one-shot deal. But it may eventually lead to other orders from the same Trinidad client and from other buyers in Trinidad or other countries. Once a trader has established fruitful business relations with a Canadian supplier he is, of course, inclined to capitalize on them and develop them to the maximum.

Whether the export initiative comes from the Canadian producer or the foreign-based buyer, the trader is at the intersection of offer and demand. Supply marketing and demand sourcing are thus two sides of the same transactional coin. In both cases, traders who are solicited for one-shot deals will aim to develop a continuous flow of goods and generate long-term market penetration and profitability. They will hope that, in time, their role as sales facilitator will evolve into that of a fully fledged export marketing intermediary, as in the case of Overseas Projects, with its exports of vacuum cleaners to Saudi Arabia.

## *Project Procurement*

Rwanda wants waiting-room furniture for a medical clinic project. Honduras is looking for forestry equipment, Chile for forest fire-fighting apparatus. An Arab country wants medical equipment for monitoring new-born infants, a South American air force something to teach artificial resuscitation. A company in Peru is looking for spare parts for an obsolete unit in a crude oil processing plant. An Australian agricultural supplier wants special parts for bailing machines. A Southeast Asian country is looking for road equipment for a major construction project.

Each of these countries has something in common: they would all like to buy from Canada. But how do they go about it? There are several ways, one of which is to call a tender. This can be done via a formal international tendering procedure through entities such as the United Nations; through any one of the international financial institutions (IFI); government-to-government; via a large multinational; or on a more informal level, by a direct telex to a company asking it for a quotation.

Some trading houses specialize in searching and sourcing goods as varied as those listed above. Once the goods are sourced, the trading house will quote ex factory prices, and costs of inland freight and export packing if necessary, to obtain an f.o.b. port price. Then they will estimate air/ocean shipping costs, documentation and all other costs such as consular certification and insurance to deliver the goods c.i.f. to the port of destination.

This format is followed whether the request is a simple one for quotation via fax or telex from a fluid sealing distributor in Panama or a complex intergovernmental tender for an IFI or the UN. Obtaining the quote, pricing all the costs of landing the goods at the port of destination and ultimately shepherding the tangible goods to the buyer is a complete service provided by the trading house to the overseas buyer.

A large link in the chain of events of a complete sourcing service is the trading house's relationship with the supplying manufacturers. They make the goods that the trading house puts together for a given tender. A trading house is best utilized where there are a number of diverse items to be assembled or where the manufacturer is inexperienced and nervous about international tenders and their procedures. A trading house is also helpful when an item is extremely difficult to source, such as spare parts for obsolete equipment where the original manufacturer has ceased operations. Normally, it is the trading house that receives the tender and initiates contact with one or more manufacturers that can supply the required goods.

Why would a manufacturer bother to quote a trading house on a tender call? First, the manufacturer likely would not know about the tender, especially if the manufacturer's goods were part and parcel of a larger requirement list. Second, the trading house has already assessed the chances of success. To pursue a tender the trading house must "feel" it can win, whether the tender is international (bidding against the world — the Japanese, Germans and all), "tied aid" available only to Canadian bidders, or a private invitation to quote. The trading house will not waste time on tenders where it would be uncompetitive; its livelihood depends on winning a reasonable percentage of what it bids on.

When a trading house contacts a firm as a potential supplier, there are several things it should do beyond merely quoting. J. Rigby, vice-president of Rigby Trade Limited, stresses the following points:

1. **Take the trading house seriously.** Accepting the specifications and then sitting on them, or waiting until the day before the bid is due and then deciding to bid, is hardly fair.

2. **Quote A.S.A.P.** Time is always of the essence. Tenders never allow enough time for leisurely responses.

3. **Quote complete.** This involves quoting the best price excluding federal sales tax, provincial sales tax, all duties and taxes ex factory price per unit, any discounts for quantity, export packaging (if necessary), and delivery to port or consolidation point. The quote must also include estimated packed weights and dimensions, estimated delivery times and validity of the prices.

4. **Include pictorial information.** Send a minimum of three sets of brochures and literature with the bid. What buyer would not like to see what he or she is getting?

5. **Include relevant information** regarding the goods, such as guarantees, spare parts, consumables, installation, maintenance, etc. Though these extras can be offered as options, including information about them will show that both the trading house and the supplier really care about their product and about servicing the buyer.

Once the trading house has all this information, the best bid possible can be presented. If awarded the contract, the trading house will monitor deliveries, arrange shipping and completion of the terms of the purchase contract. The onus to provide the product quoted on time is upon the manufacturer. In many cases, for example, Rigby Trade is the purchaser of the goods to be exported, and will take over all export functions once the goods have left the factory.

Clearly, international tendering via a trading house takes much of the sting out of the beast!

### *Trading Houses Play A Major Role In Overseas Markets...*

Their contribution amounts to a substantial share of Canadian exports...

| | |
|---|---|
| 78% | Japan |
| 65% | South America |
| 47% | Africa |
| 37% | Middle East |
| 37% | Oceania |
| 34% | European Economic Community (EEC) |

They also play a significant role in some commodity exports . . .

| | |
|---|---|
| 32% | Food, feed, beverages, and tobacco |
| 22% | Crude materials, inedible |
| 16% | Fabricated materials, inedible |

*Source: Promoting Canadian Exports: The Trading House Option.*

# *Trading Houses — How Do They Make a Profit?*

Whether they work for a commission or flat fee, or earn a profit on goods sold, the rates charged by trading houses will be a function of the following factors:

- the cost of services provided;
- the risks involved; and
- the nature of the market.

Since trading houses function as intermediaries between suppliers and buyers, they stand to make larger profits (as do their suppliers) or commissions when demand exceeds supply — depending on the level of competition in the market. Conversely, when the market is tight, trading houses and suppliers must adjust to the situation by shaving their profit margin or commission. Trading house commissions and profit margin will range from a fraction of one per cent for commodities up to 15 to 18 per cent (and sometimes more) for end-products. It should be noted that these levels cover some or all of the services and risks reviewed above. For example, in many cases the costs absorbed by the trading house will include the delay between their payment to the manufacturer and the receipt of payment from the overseas buyer.

Suitable export pricing implies proper adjustment to market conditions, as well as co-ordination between the exporting manufacturer and its trading house. Both may have to make concessions in order to remain competitive and profit from favourable market conditions.

# *When Should Trading Houses Be Used?*

Manufacturers and producers can be grouped into three broad categories: those seeking their first export markets; those already engaged in exports who are interested in diversifying their export markets; and mature exporters seeking further international expansion.

## *Starting to Export*

Manufacturers and producers may find market potential in the United States or some other destination. In the first case, although Canadian trading houses may occasionally be helpful, manufacturers are more likely to approach the market directly since it is easily accessible and has business practices comparable to those of Canada. For other destinations, especially less-developed and socialist countries which — because of cultural and administrative barriers — are more difficult to penetrate, trading houses offer a major cost-effective alternative to direct manufacturer marketing. The cost of using a trading house must be compared with what it would cost to develop an international marketing capacity and a potential clientele.

As one might expect, the trading house contribution to Canadian exports is strongest for non-U.S. destinations. Most manufacturers or producers do not have the necessary resources to cultivate such markets successfully. Trading houses, on the other hand, will have established networks in these markets so as to spread their operational costs over a larger array of products than could be provided by any single manufacturer.

### *Diversifying Export Markets*

Manufacturers or producers well established in a given market (usually Canada and the United States), may decide to penetrate one or several others. They may have the resources to do so on their own, and the capacity to absorb the market development costs involved. Even so, it might be worthwhile to have a trading company develop at least some of these new markets at a lower cost.

### *Becoming a Mature Exporter*

Small manufacturers or producers are not the only potential clients for the services of trading houses. Their larger counterparts can also benefit from trading house assistance in some cases. Mature exporters might find it to their advantage to focus directly on the development of larger markets, while using the services of trading houses to cover smaller ones. The costs of developing the in-house expertise required for success in a given market might prove prohibitive even for a large exporter, whereas such expertise would be readily available from a trading house with many years in the field.

## *Locating Trading Houses*

Canadian trading houses have formed the Council of Canadian Trading Houses, under the aegis of the Canadian Export Association. There is also a Quebec trading house association (AMCEQ: Association des maisons de commerce extérieur du Québec). Both the Council and the Quebec association can provide membership lists.

The Department of Regional Industrial Expansion (DRIE) periodically publishes a directory of Canadian trading houses which, in addition to a detailed description of the trading houses, includes very handy indices organized by province, product category and market covered. (See section on useful addresses and references at the end of this brochure.)

***Some 300 Trading Houses Have Been Identified In Canada...***

| | |
|---|---|
| British Columbia | 45 |
| Ontario | 136 |
| Quebec | 75 |
| Other provinces | 44 |
| | **Total 300** |

***...Most Of Them Are Of Modest Size***

| | |
|---|---|
| Less than $25 million in export sales per year | 254 |
| Between $25 and $100 million per year | 18 |
| More than $100 million per year | 28 |
| | **Total 300** |

*Source: Promoting Canadian Exports: The Trading House Option*

More information on trading houses can be obtained from the Trading House and Countertrade Section, Export Finance, Capital Projects and Trading Houses Division, Department of External Affairs, in Ottawa as well as from the regional offices of DRIE.

# *Selecting Trading Houses*

The manufacturing firm and its trading house are partners. That is, they embark together on transactions which, if properly conducted, should work to the mutual advantage of both. The success of such ventures requires that the partners be a good match and that they trust each other.

A proper match will not be made if there is any misunderstanding concerning the respective abilities and expectations of either party. The confidence needed for a beneficial partnership can be established only if both parties do business seriously and honestly.

To meet these conditions, the following steps in selecting trading companies should be respected:

1. The manufacturing company should carefully define its objectives and specify its needs. In particular, it should determine the projected intensity of its export activity, i.e., the share of production it can commit to export *on a regular basis*. (Capacity for occasional export activity is not enough to elicit vigorous support from a trading house.) The company should also decide which (if any) of the export tasks enumerated above it intends to perform itself. It would, for example, be a good idea for the producing firm to do a bit of its own groundwork in identifying the foreign markets which present the best potential for its products. This is a task which could, of course, be performed by trading houses. However, their focus is likely to be markets in which they are already firmly established, and these may not be the most attractive for a given producer.

2. There are a number of factors to be considered in selecting a suitable trading house, and many will have to do with the degree of *market expertise and coverage* and *type of services* sought. It is especially important for the manufacturer or producer to define the depth and nature of *product expertise* needed. This may turn out to be the key factor, since only a limited number of trading houses are likely to possess the required expertise or the capacity for developing it quickly. This does not mean that a trading house with a high level of product expertise will not have to rely on the manufacturer it represents in the course of business transactions with third parties. A manufacturing firm should know its products and end-users better than anyone else. At the same time, a trading house should be able to count on the manufacturer's technical support to develop an effective sales presentation.

   The above considerations lead inevitably to the pertinence of such dimensions as the trading company's *size* and the *length of its export experience.*

   Size should not, in itself, constitute a selection factor. While the larger company can be expected to offer wider product and market expertise, and a greater variety of services, the small manufacturing concern may well find it easier to deal with a small trading house whose services are more personalized and better tailored to its needs.

Length of experience is a much more important factor. International trade is both a difficult field of activity and one which almost anyone may enter. As a result, the casualty rate is quite high during the first years of activity. Only the fittest survive. Length of experience is therefore a definite sign of competence that should not be overlooked when selecting a trading house.

To the foregoing objective factors — market and product expertise, type of services offered, size, length of experience — which are fairly objective and easy to assess, two subjective dimensions should be added: reputation and motivation to serve.

Reputation is important. It is surprising to observe that manufacturers sometimes engage the services of a trading house without taking a fraction of the precautions normally used in choosing agents in their domestic territories. In addition to their lack of knowledge about exporting, these companies would place blind trust in a trading house about which they are ignorant. This would not be to the advantage of either party, nor to the overseas buyers.

Motivation, on the other hand, is not a dimension which can be checked with other parties. The individual manufacturing firm must assess for itself whether a trading house is strongly interested in carrying its products — in investing the time, energy, and money required to develop the sale of its products abroad. The motivational aspect will be most realistically assessed in direct discussions with the head of the trading house or trader who is taking charge of the products to be sold. Level of motivation will be reflected in questions about the products, visits to the plant, response to manufacturers' requests, etc. Motivation can be expected to increase when the personalities of trader and manufacturer prove compatible, and such a "fit" may be the best sign that a profitable business relationship can develop. The motivation and enthusiasm of the trading company will mirror the attitude of the manufacturer and the quality of their working relationship.

3. A list of trading companies should be drawn up on the basis of the above factors. Names of eligible companies can be collected from the DRIE directory, from the Council of Canadian Trading Houses' membership list and from the AMCEQ in Quebec. Trading houses accredited by the Council are highly recommended. If their reputations were questionable, accreditation would not have been granted. Nevertheless, although such accreditation does provide a certain guarantee, manufacturers are well advised not to stop their investigation at this point. Other sources of information to be considered are rating services such as Dun and Bradstreet, suppliers (past and present)

and, above all, the word of the firm's own banking connections. The search for further information will not only provide a broader base on which to make the final selection, but also afford manufacturers the opportunity to become better acquainted with trading house activities. This will, in turn, develop greater confidence in the trading house and place the manufacturing firm in a better position to set objectives and plan ahead.

# *Building an Effective Partnership with a Trading Company*

It cannot be overemphasized that the trading-manufacturing partnership will work only if both parties remember that it is meant to be a mutually profitable venture. Both must contribute their best efforts. Once this spirit of co-operation has been established — when objectives, strategies, and respective rights and obligations have been clarified — then, and only then, is it time to put these terms on paper.

According to Jack Martell, president of Martell Exporting Ltd., before undertaking any transaction, the trader and manufacturer will have to reach a clear understanding on the key dimensions that follow.

## *Product Coverage*

Manufacturers usually carry several product lines. Which lines, and which products within each line, will be exported first? Which will be introduced later? For the firm, these decisions will depend on export capacity and the international competitiveness of each product. The trader will be guided by his or her product knowledge, own product mix and sense of foreign market demands. Decisions in this area should thus be made jointly by producers and traders.

## *Product Knowledge*

A manufacturer will expect domestic marketing and sales staff to know the company's products inside out. Manufacturers rightfully fear that, otherwise, poor sales practices would result. There is no reason a manufacturer should expect less from a trading company. A trading company is, after all, the manufacturer's marketing arm abroad. A good trader will try to gain a thorough knowledge — including specifications and production process — about the products he or she represents. Such knowledge will impress potential buyers and come in handy when discussing product adaptations for foreign markets.

## Territories

Before exporting, manufacturers should find out which markets offer the best potential and approach trading companies with experience in these markets as well as suitable product competence and interest. Once a trading house is chosen, some agreement should be made concerning target markets. There are two main reasons for not granting worldwide mandates to trading companies. First, most trading companies are fairly specialized and are just not equally strong on all markets. Second, manufacturers may already act as independent exporters on certain markets or plan to do so in the future.

Manufacturers often overlook this last point as a potential source of conflict in their relations with traders. While conceding that manufacturers may eventually decide to export on their own, traders feel justified in expecting a reasonable return on the enormous efforts needed to penetrate foreign markets. When traders suspect that, once the market is developed, the manufacturer will refuse them the opportunity to enjoy the fruits of these efforts for a reasonable time, chances are their commitment to the manufacturer's interests will also be limited to short-term gains. This would cloud prospects for the kind of partnership required to succeed in export trade.

It is worth repeating that trading houses may be used for only a portion of exports. Even large exporting manufacturers do occasionally use trading companies because they realize they cannot cover all potential markets adequately.

A good case in point is the partnership between Overseas Projects and Beam mentioned earlier. Although Beam does a substantial amount of exporting on its own, it has decided that Overseas Projects can do a better job in Saudi Arabia. And, over a ten-year period, Overseas has in effect gained Beam a good sales position in a difficult market at a fraction of the cost the manufacturer would have incurred acting on its own.

### *Promotion*

Export marketing is more than export selling. Most foreign buyers expect marketing support that goes beyond samples, brochures and pamphlets to include advertising and participation in trade shows. Trading companies will want to know what and how much the manufacturer is prepared to contribute to the promotion of its products abroad. Returning to the example of the Beam-Overseas partnership, an advertising campaign is being designed for Beam in Saudi Arabia. There will have to be a financial contribution from the Canadian side, provided either by Overseas alone or jointly with Beam. Overseas will also want to know whether Beam has developed any advertising material which may be useful in Saudi Arabia.

### *Contract*

A contract is just as necessary in exporting as in domestic business. It should be viewed not only as a means of legal protection, but also as an instrument for fostering the clearest possible understanding between two parties. Lastly, the manufacturer or the trading house will remember that a contract which attempts to wring every last concession from the other party is not an achievement, but rather a sure sign that the deal will never work. Indeed, a contract will bear fruit only to the degree that it incorporates terms which work to the equal advantage of all contracting parties.

## *Pricing for Export Success*

Traders serve as intermediaries in matters which relate not only to product specifications but also to price. As regards price, they negotiate with both the seller and buyer. Their role is likely to involve getting the foreign buyer to accept a higher price or the seller a lower price or convincing both of them to compromise when they are too far apart. It may also include negotiating better terms for freight, insurance handling and financial costs.

### *Demand Pricing*

For an example of demand pricing, one can go back to the case of exports of wheelbarrows to Trinidad. Mr. Kampouris has found a Canadian supplier who is offering to meet the delivery deadline with a product of the required specifications at a price of $41.72 (Cdn) ex plant — after quantity and cash discounts, and net of federal tax which does not apply on exports.

Naim in Trinidad already has an offer from the Danes at $31.00 (US) $43.09 (Cdn) c.i.f. Port of Spain. Mr. Kampouris first tries to get Mr. Naim to go higher. The answer is "No." Mr. Naim remains unimpressed by the superior quality of Canadian wheelbarrows; even if they are the world's best, he would still prefer to have his 600 wheelbarrows at $31.00 (US), or even cheaper. In this particular case, the trader can either try to meet the buyer's conditions or let the deal drop. Mr. Kampouris decides to pursue the transaction.

## *Export Costing*

At this stage, Mr. Kampouris calculates the c.i.f. price based on the manufacturer's offer and the direct exporting costs involved. The results (per wheelbarrow) of his computations are given below:

| | | | |
|---|---|---|---|
| | Net f.o.b. ex plant (manufacturer's offer) | | $41.72 |
| + | Direct Exporting Costs (DEC) | | |
| | Inland freight | 0.37 | |
| | Handling | | |
| | Storage | | |
| | Marking | | |
| | Preparation and delivery containers | 4.67 | |
| | Wharfage | | |
| | Overseas freight | | |
| | Interest | 1.30 | |
| | Banking costs | 0.12 | |
| | Insurance | 0.30 | |
| | Total DEC | | 6.76 |
| = | Total, c.i.f. before profit | | 48.48 |
| + | Targeted profit | | 3.39 |
| = | Total c.i.f., including targeted profit | | $51.87 (Cdn) |

Mr. Kampouris is faced with a major gap between a demand price of $43.09 and an offer price of $51.87. The first thing he will do is figure out how he can save on direct exporting costs and decide how much he can reduce his targeted profit.

By finding a cheaper mode of transportation and better credit terms, he manages to cut his DEC by $1.10. Because he is interested in the transaction, he is also willing to cut his targeted profit to $2.50 per wheelbarrow. As a result, he can reduce the c.i.f. price by $3.60 to $48.27. It is still a long way to go. What is the manufacturer willing to do?

With DEC now at $5.36 and his profit at $2.50 Mr. Kampouris figures that in order to meet the requested c.i.f. prices of $43.09 he has to get the manufacturer to agree to an f.o.b., ex plant offer no higher than:

| | | |
|---|---|---|
| | C.i.f., including profit | $43.09 |
| − | New targeted profit | −2.50 |
| = | C.i.f., before profit | 40.59 |
| − | Revised DEC | −5.66 |
| = | Maximum f.o.b., ex plant | $34.93 |

The manufacturer's first offer was $41.72. There is a gap of $6.79. Mr. Kampouris prepares himself for some tough bargaining. He must aim for an f.o.b. of at most $34.93 but would prefer something like $34.00 which would not eat up so much of his profit. He decides to start negotiating at $32.00.

## *Manufacturer Costing*

The manufacturer's response to Mr. Kampouris is at first an unyielding "No." He has never exported and he has certainly never sold his wheelbarrows anywhere for less than $41.00. On the other hand, he is tempted by the idea of exporting and he has the materials and some seasonal unused production capacity. Despite the firmness of his first "no," he agrees to see what he can do to lower his price. He consults his accountant concerning the direct costs of wheelbarrows. Here is a summary of the statement prepared by the accountant:

### *Wheelbarrow per Unit Cost*

| | | |
|---|---|---|
| | Materials and labour | $20.52 |
| + | Factory burden | 4.20 |
| + | Marketing costs (sales, advertising, etc.) | 3.82 |
| + | Administration | 7.73 |
| = | Total costs | 36.27 |
| + | Average profit on local sales | 5.45 |
| = | Basic sales price, ex works, net of discounts and federal tax | $41.72 |

The accountant makes several observations. First, the marketing costs ($3.82) do not apply to exporting but only to domestic sales and could thus be shaved from export costing. Second, since plant operations are currently 20 per cent below production capacity, the factory burden ($4.20) actually represents sunk costs that are incurred whether or not the export order is accepted. Third, there are almost no administrative costs involved in the transaction, since the trading company will pick up the product at the plant in return for cash payment and then handle exporting. In addition, the accountant points out that, like factory burden, administrative costs ($7.73) are sunk costs and already covered by domestic sales.

He concludes that, keeping to the average profit margin, the wheelbarrows could be sold to the trading company for as low as:

| | | |
|---|---|---|
| | Material | $20.52 |
| + | Profit | +5.45 |
| = | Minimum f.o.b., ex plant for export | $25.97 |

The president of the manufacturing firm is not entirely convinced by this conclusion. He is opposed in principle to the idea of selling so low and he observes that it would be unwise to set a precedent of "subsidizing exports at the expense of domestic operations." Still he feels it would be great to export and the trading company's offer is really tempting. They do the work and he makes a quick $3000 dollars. He decides to continue negotiations.

Mr. Kampouris is asking for $32.00, so he starts quite comfortably at $36.00, knowing that he can go well below that price. There follow a few rounds of final offers and counter offers, peppered on both sides with remarks about "how hard it is to make a buck these days." But, they finally agree on an f.o.b. ex plant of $34.33 and Mr. Kampouris manages to get some $200.00 worth of spare parts included at no cost.

The deal turns out to be quite lucrative for all three parties. At $34.33 f.o.b. ex plant, the trading company makes $3.10 ($43.09 [landed target price in Port of Spain] less $5.66 [DEC] less $34.33) per wheelbarrow, fairly close to his original targeted profit of $3.39. The manufacturer makes the usual average profit of $5.45 and in addition gains a contribution to overhead (factory burden, administration and marketing costs) of $8.36 ($34.33 – $25.97). For this particular operation, the reverse of what was feared happens: exports subsidize domestic activities rather than the reverse. The importer gets the same price as he would have had from Denmark. He also saves by not having to pay interest or letter of credit charges (since the trading house didn't require one). The free parts are included in the deal and an additional intangible advantage is that Naim is buying from his friend Kampouris whom he trusts and who will be there to solve any problems which may arise.

While the above example relates to the establishment of a price in a demand sourcing situation, the factors considered are also relevant in a supply marketing situation. Furthermore, some general observations can be made concerning this case that apply to export pricing as a whole.

First, as an export intermediary the trading house plays a key role in linking supply and demand and in obtaining the best possible export conditions, particularly with regard to transportation and financial costs.

Second, manufacturers should pay close attention to costing for export. They should not include such things as non-applicable domestic marketing costs and should carefully scrutinize the applicability of overhead costs related to factory burden and administration.

Third, negotiations between manufacturers and traders must be quite open-ended. An open-book policy will actually pay off for both sides when it comes to setting prices and conditions to win overseas contracts.

This approach to negotiations can only be built on mutual trust. Trust is the essential basis for establishing trader-manufacturer partnerships that can be winning propositions on today's intensely competitive international scene.

# *Useful References and Addresses for Information on Canadian Trading Houses*

***Publications:***

*Promoting Canadian Exports: The Trading House Option,* External Affairs, Ottawa, 1984.

*Directory of Canadian Trading Houses*, Department of Regional Industrial Expansion, Ottawa, annual.

*Corporate Trading Companies: A Response to Market Globalization and Countertrade*, Seminar Proceedings, External Affairs, Ottawa, June 1986.

These publications are available from the organizations listed below or the regional offices of the Department of Regional Industrial Expansion.

***For more information on the trading house sector:***

The Council of Canadian Trading Houses
99 Bank St., Suite 250
Ottawa, Ontario K1P 6B9
Tel.: (613) 238-8888
Telex: 053-4888

Association des maisons de commerce extérieur du Québec (AMCEQ)
666 ouest, rue Sherbrooke
Pièce 201
Montréal (Québec) H3A 1E7
Tel: (514) 286-1042
Telex: 055-62171
Destination Code 1467
Fax: (514) 284-2282
Destination Code 1467

Export and Transportation Services Division
Department of External Affairs
125 Sussex Drive
Ottawa, Ontario K1A 0G2
Tel: (613) 996-1862
Telex: 053-3745
Fax: (613) 996-9103

Service Industries Branch
Department of Industry, Science and Technology
235 Queen St.
Ottawa, Ontario K1A 0H5
Tel.: (613) 954-2984
Telex: 053-4123
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