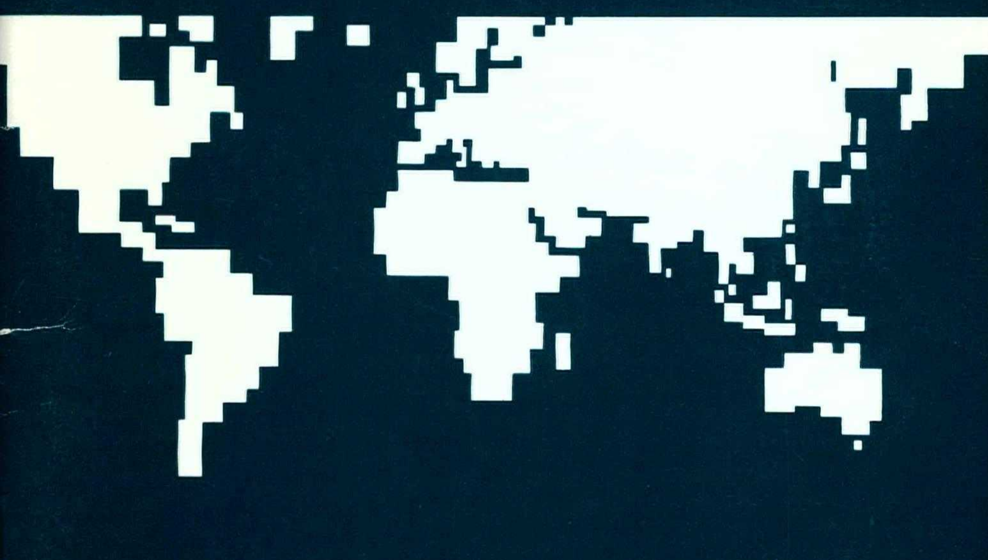
Export Markets:

The Trading House Connection



External Affairs and
International Trade Canada

Canada

Export Markets:
The Trading House Connection

Canada 1991

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Foreword

This publication on the use and selection of Canadian trading houses is one in a series of publications aimed at addressing the distribution and transportation needs of Canadian exporters. Other publications in this series that are currently available include *Selecting and Using Manufacturers' Agents in the United States* and *Countertrade Primer for Canadian Exporters.* Upcoming releases in this series include *Selecting and Using Foreign Agents and Distributors, A Guide to Export Transportation, Documentation and Trade Finance* and *Safe Stowage.*

Novice exporters are encouraged to study the publication *Export Guide: A Practical Approach* before embarking upon these more detailed and technical publications. Sources for all the above noted releases are provided in the Appendix at the end of this book.

Exporters are invited to submit their comments regarding this publication, and suggestions for others which may be useful to them in the course of increasing Canadian exports, to:

Business and Transportation Services Division
External Affairs and International Trade Canada
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Ottawa, Ontario
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Introduction

Trading houses are the topic of much discussion in Canada but very little is known or written about their actual role and function.

Typically, members of the Canadian business community regard a trading house as a one-person operation that tries to make an inflated commission, adds nothing to a transaction and makes a Canadian product uncompetitive in the process. There are several reasons for these misconceptions.

First, many well-established trading houses avoid labelling themselves as such and prefer to operate out of the public's view to discourage new competition. Further, most indigenous Canadian trading houses are relatively new, having been established within the past 20 years. As a result, Canadians, relative to their counterparts in Germany, Japan, Korea, the United Kingdom, etc., are unfamiliar with the benefits of working with a trading house and its important role in world trade. Finally, because of low barriers for establishing new companies, there is a high turnover of new inexperienced trading houses, many of which offer anything anywhere. In the process, this leaves a bad impression of trading houses with manufacturers, government officials and foreign customers.

These factors have given trading houses a poor image that is, as statistics show, unjustified. In 1983, Canada-based trading houses accounted for 40 per cent of Canada's non-U.S. exports.

To bring to light the significant role of trading houses, the Council of Canadian Trading Houses was established in 1985, with a mandate to provide an accreditation procedure for trading houses that would assure potential users of track records and reliability, and to promote a better understanding of the capabilities and benefits offered by trading houses in general. To date, both these measures have met with great success; the environment for trading houses in Canada is now far more favourable.

There is, however, still room for improvement. As globalization continues and foreign competition increases at home and abroad, the knowledge that Canadian trading houses possess on foreign markets becomes even more valuable. The purpose of this publication is to clarify for the Canadian business community the role and function of trading houses in Canada, their potential for increasing exports to overseas markets, and the most beneficial ways of working with them.

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 Canada-based producers and foreign-based purchasers or consumers of goods and services.

The Trading House Task Force of 1984-85 defines trading houses as:

> Companies specialized in the exporting, importing and third-country trading in goods and services produced or provided by other parties, and which provide related services to these activities.
>
> These companies may act as merchants, agents, export managers, export consortia, export co-operatives, buying houses and procurement agents, or as a combination of the above.

Under this definition we find that many companies operate as trading houses but may not be identified or consider themselves as such.

As intermediaries, some act on their own account as merchants, actually buying and selling for profit and therefore taking title to 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.

For the most part, well-established and experienced companies act on a merchant basis. However, in practice the procedures seldom turn out to be 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. As noted below, whether a trading house operates on a merchant or commission basis is not as important as its track record, and the experience of individuals within the firm and their market knowledge.

What Categories of Trading Houses Exist in Canada?

Approximately 500 to 600 trading houses exist in Canada. An accurate number is difficult to determine because there is no requirement for registration and they do not advertise their existence. Generally speaking, seven different categories of trading houses can be identified according to their size, function and activities. These include:

1. Corporate, co-operative, or single commodity trading houses which may act independently or as the international sales or marketing arm of affiliated producers or co-operative members. These are commonly found in the grain, mine and minerals, pulp, paper, lumber, fish, livestock and agro-food sectors. In most cases, they are export-only oriented and many have sales in excess of $50 million.

2. Domestic distributors and mass merchandisers. In recent years many companies have created international distributing functions to capitalize on their existing products and financial strengths. To date, most are in the industrial supplies areas (i.e., plumbing, electrical and building hardware). A number of mass merchandisers and food retailers now also have export functions.

3. Agro-food traders. These companies range in size from $5 to $50 million and trade a variety of food products. Changing global market conditions require that they be active in exporting, importing and third-country trading.

4. Niche trading houses. These companies are product and/or market oriented. They can be characterized as:

   Product focussed: They have a wide knowledge of products in a particular industry sector with established markets or supply for identified opportunities worldwide.

   Market focussed: They are frequently staffed by expatriates with business experience and contacts in a particular country or region. They have the advantage of first-hand knowledge of markets, business practices and requirements.

   In addition, these companies tend to be independent, small ($1 to $25 million in sales), primarily active in end products and fabricated materials, entrepreneurial and opportunity oriented, and relatively young (less than 20 years in business).

   This is the category that dominates and holds the most potential; it reflects the greatest growth rates and has the most new entrants and failures.

5. Foreign trading houses of Japanese, Korean and European origin exporting primarily raw materials and commodities and importing

fabricated and end products. Many of these companies have secured their supply sources through equity investments in resource companies. More recently the trend has been towards investing in small to medium-sized enterprises with proven new high technology. These companies are often seen as multinational conglomerates rather than trading companies.

6. Importers. Many originally import-only companies are finding new opportunities in the export arena through their knowledge of Canadian suppliers and industry and foreign contacts. Interestingly, many of the large foreign trading houses began by importing and then expanded to include exporting.

What Role Do Trading Houses Play in Canadian Exports?

The Task Force found that in 1983, trading houses accounted for 40 per cent of Canada's non-U.S. exports. This is a good indication that their strength lies in their knowledge of offshore markets.

The small and medium-sized trading houses (primarily the agro-food and niche trading houses) account for 80 per cent of the sector's population and 20 per cent of the volume. Ninety per cent of the sector is Canadian-owned and is responsible for two-thirds of the sector's transactions.

The fact that a sample of Canadian trading house exports mirrors total Canadian exports by sector confirms the necessity of competitive products. Trading houses are only as good as the suppliers behind them. Their expertise is in selling to non-U.S. markets, that is, offshore countries and developing nations. For the small to medium-sized trading houses active in end products, fabricated materials and food products, this means Europe, the Caribbean, Central America, the Pacific Rim and Middle East.

Trading Houses ... How Do They Operate?

To better understand trading houses and what relationship your company may have with them, it is worthwhile to describe their two primary modes of operation:

- **In supply marketing**, a trading house has a formal or informal agreement to act as an international distributor (in one or more markets) for a Canadian supplier. This procedure is detailed below and much of this publication describes how to work with a trading house in this context.

- **In a demand sourcing/market driven/opportunity mode,** a Canadian trading house identifies a need for a product through its contacts, agents or representatives, and then sources for such an opportunity in Canada or elsewhere if competitive Canadian sources cannot be found.

A subsector of demand sourcing is project procurement, where companies respond to national or international tenders for projects or foreign government requirements.

If we combine the two primary modes according to whether they act as a principal or agent, the following chart provides examples, in general terms, of the major forms of trading houses.

	Principal	Agent (fee or retainer)
Supply driven	International wholesale distributor, export merchant or representative	Commissioned representative or agent, export management company
Market driven	Export merchant, buying house or agent	Commissioned agent / finder, foreign agent

The above chart is by no means inclusive and many exceptions do exist.

Trading houses may be operated in one or several of these combinations depending on their preference and the particular circumstances. Relationships with the supplier and mutual responsibilities of the supplier and trading house will differ in each situation. For manufacturers seeking a trading house to develop or to assist them in the development of markets, the two supply driven modes are appropriate. On the other hand, trading houses will frequently approach suppliers in sourcing for overseas spot transactions. While these opportunities should not be ignored, as they may develop into substantial future sales and/or market development opportunities, normal business precautions should be taken with respect to credentials, as many novice traders begin in this mode. (See Locating Trading Houses and Selecting Trading Houses below.)

Supply Marketing

Under this exporting mode, trading companies may act as export management companies, export consortia, export representatives 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, in a situation where, for example:

- 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.

To summarize, trading companies will follow up on these short-term deals if they offer opportunities for profit.

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

In this mode, Canadian manufacturers who wish to export have, at their disposal, trading houses which can provide a 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.

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 displays in the largest building exhibitions and home shows in the Middle East.

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

The captioned 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:

- finding, selecting and evaluating potential clients;
- identifying their needs and product adaptation requirements;
- mastering their business customs, building an atmosphere of trust and respect; and
- 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 supplies 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 development in Canada. A significant number of Beam products have been 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 Canada-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 merchants and agents 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.

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

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. A trader who has established fruitful business relations with a Canadian supplier 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 an ongoing 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 newborn infants, a South American airforce needs 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 baling machines. A Southeast Asian country is looking for road equipment for a major construction project.

All of these countries have 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 (UN); through any international financial institution (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 international financial institution 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 etc.), "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.

What Does a Trading House Look for from a Supplier?

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. Buyers like to see what they are getting.

5. **Include relevant information** regarding the goods, such as guarantees, spare parts, consumables, installation and maintenance. 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, and arrange shipping and completion of the terms of the purchase contract. The onus to provide the product quoted on time is on 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 makes transactions far easier.

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 Community (EC)

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 (payment and transportation); 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 1 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 Canada's. 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 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.

Commitment, motivation and timeliness by the manufacturer are prerequisites for working with a trading house. Trading houses often report that companies contact them for assistance in exporting and then leave them waiting for a simple reply regarding brochures, prices, delivery, etc. Reliable and supportive suppliers are a must when potential export sales and the offshore reputation of the trading house are at stake.

Locating Trading Houses

Canadian trading houses have formed the Council of Canadian Trading Houses. There is also a Quebec trading house association (Association des maisons de commerce extérieur du Québec [AMCEQ]). Both the Council and the Quebec association can provide membership lists describing their members' products and market interests and, in some cases, volume.

Industry, Science and Technology Canada (ISTC) 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 publication).

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

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

... Most 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.

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 their mutual advantage. 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 listed above it intends to perform itself. It would, for example, be a good idea for the producing firm to do some of its own groundwork in identifying the foreign markets which present the best potential for its products. This is a task that could, of course, be performed by a trading house. However, its focus is likely to be markets where it is 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 amount of 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.

   Experience is a much more important factor. International trade is a difficult field of activity yet 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. Amount of experience is therefore a definite sign of competence that should not be overlooked when selecting a trading house.

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

Reputation is important. Surprisingly, some manufacturers engage the services of a trading house without taking the precautions normally used in choosing agents in their domestic territories. Already disadvantaged by a lack of knowledge about exporting, these companies place their trust in a trading house about which they are ignorant. Such choices bring no advantage to 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 can be most realistically assessed in direct discussions with the head of the trading house or the 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 and responses to manufacturers' requests. 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 ISTC directory, from the Council of Canadian Trading Houses' membership list and from AMCEQ in Quebec. A trading house accreditation from the Council is a good initial recommendation, although manufacturers are advised to investigate still further. Other sources of information to be considered are rating services (such as Dun and Bradstreet), suppliers (past and present) and, above all, 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 consider it as 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 must 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 product knowledge, the product mix and a 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 have a thorough knowledge of the company's products so that good sales practices are maintained. There is no reason why a manufacturer should expect less from a trading company, which 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 to be represented. 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 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, it is likely their commitment to the manufacturer's interests will also be limited to short-term gains. Such attitudes contribute little to the partnership required for success 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 case in point is the partnership between Overseas Projects and Beam mentioned above. 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 10-year period, Overseas Projects 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 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 Projects 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 Projects alone or jointly with Beam. Overseas Projects will also want to know whether Beam has developed any advertising material that 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 should 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 be a success only to the degree that it incorporates terms that work to the equal advantage of all contracting parties.

Pricing for Export Success

Traders serve as intermediaries in matters that 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 persuading the foreign buyer to accept a higher price or the seller a lower price or convincing both to compromise when they are too far apart. It may also include negotiating better terms for freight, insurance handling and financial costs.

For an example of pricing in a demand sourcing situation, return to the case of wheelbarrow exports 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 C$41.72 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 US$31.00 (C$43.09) c.i.f. Port of Spain. Mr. Kampouris first tries to get Naim to go higher. The answer is "No." 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 US$31.00, 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 as follows:

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

Mr. Kampouris is faced with a major gap between a demand price of C$43.09 and an offer price of C$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 C$1.10. Because he is interested in the transaction, he is also willing to cut his targeted profit to C$2.50 per wheelbarrow. As a result, he can reduce the c.i.f. price by C$3.60 to C$48.27. It is still a long way to go. What is the manufacturer willing to do?

With DEC now at C$5.36 and his profit at C$2.50, Mr. Kampouris calculates than in order to meet the requested c.i.f. price of C$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	C$43.09
–	New targeted profit	– C$2.50
=	C.i.f., before profit	C$40.59
–	Revised DEC	– C$5.66
=	Maximum f.o.b., ex plant	C$34.93

The manufacturer's first offer was C$41.72. There is a gap of C$6.79. Mr. Kampouris prepares himself for some tough bargaining. He must aim for an f.o.b. of at most C$34.93 but would prefer something like C$34.00 which would not eat up so much of his profit. He decides to start negotiating at C$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 C$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 his initial "No," he agrees to see what he can do to lower his price. He consults his accountant on the direct costs of wheelbarrows. Here is a summary of the statement prepared by the accountant:

Wheelbarrow per Unit Cost

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

The accountant makes several observations. First, the marketing costs (C$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 (C$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 (C$7.73) are sunk costs that are 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	C$20.52
+	Profit	C$5.45
=	Minimum f.o.b., ex plant for export	C$25.97

The president of the manufacturing firm is not entirely convinced. 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 is keen to export and the trading company's offer is tempting. They do the work and he makes a quick C$3 000 dollars. He decides to continue negotiations.

Mr. Kampouris is asking for C$32.00, so he starts quite comfortably at C$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 C$34.33 and Mr. Kampouris manages to get some C$200.00 worth of spare parts included at no cost.

The deal turns out to be quite lucrative for all three parties. At C$34.33 f.o.b. ex plant, the trading company makes C$3.10 (C$43.09 [landed target price in Port of Spain] less C$5.66 [DEC] less C$34.33) per wheelbarrow, fairly close to his original targeted profit of C$3.39. The manufacturer makes the usual average profit of C$5.45 and in addition gains a contribution to overhead (factory burden, administration and marketing costs) of C$8.36 (C$34.33 – C$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 did not 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 that 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.

1. 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.

2. 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.

3. 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 win on today's intensely competitive international scene.

Appendix

References and Addresses for Information on Canadian Trading Houses

Publications:

Membership Directory of the Council of Canadian Trading Houses, 1990-91.
Available from the Council of Canadian Trading Houses,
99 Bank Street, Suite 250,
Ottawa, Ontario, K1P 6B9.
Tel: (613) 238-8888;
Fax (613) 563-9218.

Directory of Canadian Trading Houses, Industry, Science and Technology Canada. Annual. Available from Business Opportunities Sourcing System, Industry, Science and Technology Canada,
235 Queen Street,
Ottawa, Ontario, K1A 0H5.

Selecting and Using Manufacturers' Agents in the United States,
External Affairs and International Trade Canada.

Export Guide: A Practical Approach,
External Affairs and International Trade Canada.

The latter two publications and other publications of External Affairs are available through Info Export, External Affairs and International Trade Canada, 125 Sussex Drive, Ottawa, Ontario, K1A 0G2. Tel: (toll-free) 1-800-267-8376.

For more information on the trading house sector:

The Council of Canadian Trading Houses
99 Bank Street, Suite 250
Ottawa, Ontario K1P 6B9
Tel: (613) 238-8888
Telex: 053-4888
Fax: (613) 563-9218

Association des maisons de commerce extérieur du Québec (AMCEQ)
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Business and Transportation Services Division
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Service Industries Branch
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