

Export strategy: advantages and disadvantages



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1. 0. EXECUTIVE SUMMARY

The purpose of this report was to analyze the different strategies for exporting that are available to an organization internationalizing for the first time. Specific objectives were to identify the drawbacks and benefits of an export strategy. The report recommends an organization taking up exporting as a means of internationalization but also emphasizes that for exporting to be fully successful, the organization must approach it in a systematic way so that it may derive the full benefits associated with exporting.

2. 0. TERMS OF REFERENCE

My name is Amina J M Matongo, I am a student studying for my Bachelor of Arts in Business Studies at The Zambia Centre For accountancy Studies through the Greenwich University. The content in this report is based on examining different export strategies available to a firm wishing to internationalize for the first time and the advantages and disadvantages of an export strategy.

3. 0. METHODOLOGY

The information contained and gathered in this report has been collected from international business literature, texts, past knowledge and the World Wide Web.

4. 0. INTRODUCTION

A number of market entry strategies are available for a firm wishing to internationalize into foreign markets. Entry strategies include Exporting, Licensing, Franchising, strategic alliances, joint ventures and wholly owned subsidiaries. But because exporting entails limited risk, expense and

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knowledge of foreign markets and transactions, most organizations prefer exporting as their primary foreign market strategy. Exporting is a strategy of producing products or services in one country (often the producer's home country), and then selling and distributing to customers in another country. The organization that is exporting retains its manufacturing activities in the home market but conducts marketing, distribution and customer service activities in the export market, the firm may conduct the latter activities itself or contract with an independent distributor or agent to have them performed (Cavusgil, Knight , Riesenberger).

Organizations venturing abroad for the first time, use exporting as an entry strategy, but beyond primary entry, all types of firms, large and small use exporting regardless of their stage of internationalization. Large companies such as Boeing and Toyota have used exporting in conjunction with other entry strategies.

Compared to more complex strategies such as foreign direct investment (FDI), the exporter can both enter and withdraw from the markets fairly easily, with minimal risk and expense. Exporting may be employed repeatedly during the firm's internationalization process.(reference 1)

4. 1. The reasons why organizations internationalize include

To seek opportunities for growth through market diversification. Substantial market potential exists outside the home country and this is how firms both large and small generate more than half their sales from markets abroad.

Many foreign markets may be underserved for example high emerging markets, thus they have high demand and less intense competitive pressures which entails higher margins and profits for the firm.

Firms are better able to serve key customers who have relocated abroad. For example when Toyota opened it's first factory in the UK, many Japanese auto parts suppliers followed, establishing their own operations there.

To gain access to lower-cost or better-value factors of production . Internationalization enables the firm to access capital, technology, managerial talent, labor and land at lower costs, higher quality, or better overall value at locations worldwide.

Another driver for internationalization is that the firm is able to develop economies of scale in sourcing, production, marketing and R&D . Also the firm will be closer to supply sources, benefit from global sourcing advantages, and gain new ideas about products, services and business methods. Unique foreign environments expose firms to new ideas for products, processes and business methods. (reference 2).

5. 0. DISCUSSION

According to Cavusgil, Knight and Riesenberger, the more experienced managers will use a systematic approach to exporting to improve the firm's prospects for successful exporting.

This approach should be as follows:

5. 1. 1. Step one, assess global market opportunity

Management assesses the various global market opportunities available to the organization. The organization's readiness to internationalize and choose the most attractive export markets, identifies qualified distributors and other foreign business partners then estimates industry market potential and company sales potential.

5. 1. 2. Step two, organize for Exporting

The second step is for managers to address the questions of what types of financial, managerial and productive resources should be committed to exporting? And to what extent should the firm rely on domestic and foreign intermediaries to carry out exporting? Options open to the organization are either to use indirect exporting which is exporting through intermediaries in the home market or direct exporting which is through intermediaries in the foreign market.

5. 1. 3. Step three, Acquire needed skills and competences

Exporting is often complex and as a result requires specialized skills and competencies. Meaning the organization will need to acquire these skills and competencies, train staff and engage appropriate facilitating firms such as freight forwarders , bankers etc.

5. 1. 4. Step four, Implement the export strategy

In this final stage, management formulates elements of the organization's export strategy. This may involve product adaptation to modify a product to make it fit the needs and tastes of buyers. In export markets with many competitors, the exporter needs to adapt its products/services in order to

gain a competitive advantage. For example when Microsoft markets computer software in Germany, it must ensure the software is written in German.

Marketing communications adaptation refers to modifying advertising, selling, public relations and promotional activities to suit individual markets. Marketing activities are adapted depending on the nature of the target market, nature of the product/service, the firm's position relative to competitors and management's specific goals and objectives.

Price competitiveness refers to efforts to keep foreign pricing in line with that of competitors, the exporter may need to charge competitive prices . In the case of small and medium enterprises (SME's), they may lack the resources to compete head to head on pricing with larger rivals. Such companies do not compete based on price but by emphasizing the non-price benefits of their products/services such as quality, reliability and brand leadership.

Distribution strategy often hinges on developing strong and mutually beneficial relations with foreign intermediaries. Companies provide ongoing support to distributors and subsidiaries in the form of sales force, training, technical assistance, marketing know how, promotional support and pricing incentives. In markets with numerous competitors, the exporter may need to boost the capabilities of distributors.

SOURCE: Adapted from Cavusgil ' et al', strategy, management and the new realities, pearson, 2008. pg 391.

6. 0. STRATEGIES FOR EXPORTING MAY BE LOOSELY GROUPED INTO THREE CATEGORIES

6. 1. Direct Exporting

Direct exporting involves direct marketing and selling to the client that is contracting with intermediaries located in the foreign market to perform export functions; intermediaries include foreign based sales agents and distributors.

These intermediaries or agents perform downstream value chain activities in the target market. If a firm has a reasonably accessible market, direct exporting of products and services may be a viable option . But where the firm faces less familiar markets with different legal and regulatory environments, business practices, customs and or preferences, direct exporting may not be an attractive option. A local partner for example may be better able to manage these complexities and serve the organization's potential client's better.

6. 1. 1. Advantages of direct exporting

The exporting company will be able to establish a direct contact with a foreign trading partner, and not only operates through it's own foreign trade companies abroad but also has the best opportunity for direct participation in foreign transactions.

Target management and control of the sales become possible which is unrealistic in the case of indirect exports.

The strategy offers potential for higher profits because of more direct contact.

Direct exports may also enable the producer to have a closer relationship with foreign buyers and the marketplace.

Direct exporting is applicable to a wider range of goods and services.

6. 1. 2. Disadvantages of direct exporting

Direct exports are affected by other conditions. For example, the deterioration of exchange rates, if the rate of domestic currencies of third countries increases on the markets where the firm exports, it may cause the company to become relatively uncompetitive in overseas markets.

Direct exporting may be inappropriate for goods with a short work life and are unlikely to be exported, goods such as those which may have high transport costs or goods that require complex after-sales service which cannot be granted by resellers.

Direct exporting may require the producer to acquire new capabilities like marketing skills and financial resources in order to be able to contract with clients or business partners.

6. 2. Indirect Exporting

This method of exporting is mainly used by producers in the transportation, Automobile and Equipment manufacturing industries. For example, the Toyota Motor corporation.

Indirect exporting entails contracting with intermediaries in the producer's home country to perform export functions; these are intermediaries such as an export management company (EMC) or a Trading company. These

intermediaries are responsible for finding foreign buyers in the target market, shipping products and receiving payment.

The types of intermediaries

Domestic based exporting merchants who sell the products abroad and domestic based export agents who sell on behalf of the exporter but do not take title of the products; agents are usually paid by commission.

The producer/ exporter should exercise caution when selecting an agent or distributor for indirect exporting.

6. 2. 1. The advantages of indirect exporting

The principal advantage of indirect exporting for most organizations is that it provides a way to penetrate the foreign markets without the complexities and risks of more direct exporting. The international organization can start exporting with no incremental investment in fixed capital, low startup costs and few risks, but with prospects for incremental sales.

The exporter will have less complexity in dealing with when selling products in foreign markets, complexities which range from clashing cultures to volatile exchange rates.

The exporter will not have to worry about managing product distribution in a foreign country as this is done by an export partner.

The market entry barriers tend to be less in this form of exporting.

In indirect exporting, the legal relationships exist between the organization's supplier (intermediary) and its immediate client buyer. Questions of

jurisdiction in international lawsuits become less of an issue for the indirect exporter.

The aspect of managing ongoing end user relationships is eliminated for the producer.

Compared with other forms of access to foreign markets and their development, indirect exports require scarce resources. This will be an advantage for small and medium enterprises (SME's) wishing to internationalize.

The producer will have more time to focus on the core competencies of their business operations.

Indirect exporting does not require a lot of organizational effort or commitment of staff workers, the firm only employs a small number of employees as the main work is carried out by foreign trade partners.

In the event that this export strategy does not lead to achievement of goals, the exporter can easily withdraw from the market.

6. 2. 2. The disadvantages of indirect exporting

The main disadvantage of indirect exports is that not all brokers are using the optimum market potential and opportunities for marketing, thus mistakes and miscalculations in their actions affect the income of producers of export goods.

Indirect exporting may lead to diminishing returns in the long run as trading partners try to get maximum profit from their service as mediators.

While the exporter using intermediaries to export can save a lot of money in the short and medium term, this type of supplier has little or no control over the business activities in international markets.

By using an intermediary, the indirect exporter may lose out on brand recognition and loyalty in international markets, thus leaving this opportunity and domain to larger firms.

Lastly the producer using indirect exports may lack recognition from the end users of the product or service, who are much more familiar with the end product.

6. 2. 3 The third option open to exporters is to export by establishing strategic partnerships with other organizations or individuals that have complementary skills or capabilities. The partner may often provide the insight, contacts and experience that fill the gap in the organization's export readiness.

The advantage is that an alliance with a company selling a complementary product or service can provide the producer with more effective market access, resulting in more foreign sales in less time.

A disadvantage may be that the two partners will not achieve synergistic benefits causing a failure in organization's export ventures.

It should be noted though that many organizations use both approaches for different foreign markets. Key issues for deciding whether to use direct or indirect exporting are (1) the level of resources in terms of time, capital and managerial expertise that management is willing to commit to international

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expansion and individual markets;(2) the strategic importance of the foreign market; (3) the nature of the firm's products, including the need for after sales support and (4) the availability of capable foreign intermediaries in the target market.(reference 3).

7. 0. AN EXPORT STRATEGY

As mentioned earlier , exporting is the strategy of producing in the home country and then selling to buyers in foreign markets or abroad .

Organization's that use exporting as a strategy include 3M (the Minnesota Mining and Manufacturing Co.) which makes tape, sand paper and medical products amongst other products. 3M is a major exporter with revenues of over \$2billion in exports. Another export success story is FCX (based in west Virginia) systems which makes power converters for the aerospace industry , this organization generates over half of it's \$20million in annual sales from exports to more than 50countries(reference 4), a third example would be the Toyota Motor Corporation.

The advantages and disadvantages of exporting to the above named organizations are:

7. 1. Advantages

Organizations can increase sales volume, improve market share and generate profit margins that are often more favorable than in the domestic market.

The exporter is able to diversify the customer base, reducing dependence on home markets. For example Toyota is in different regions thus they have a diverse customer base.

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Economies of scale will increase and therefore reduce the per unit cost of manufacturing.

Exporting allows the exporter to minimize risk and maximize flexibility that is compared to other forms of internationalization. If situations necessitate, the firm can quickly withdraw from an export market.

As compared to other forms of entry, exporting is a low risk, low cost strategy as it does not require the exporter to establish a physical presence there. Organizations can test potential markets before committing greater resources.

The exporter is able to stabilize fluctuations in sales associated with economic cycles or seasonality of demand. For example, a firm can offset declining demand at home due to an economic recession by refocusing efforts toward those countries that are experiencing more robust economic growth.

Also the exporter is able to leverage the capabilities and skills of foreign distributors and other business partners located abroad.

Lastly the exporting organization is able to develop meaningful foreign relationships abroad.

7. 2. Disadvantages

Compared to foreign direct investment, the exporter has fewer opportunities to acquire and learn knowledge about customers, competitors and the marketplace. Meaning that it may fail to perceive opportunities and threats.

An export strategy will require the organization to acquire new capabilities and dedicate organizational resources to properly conduct export transactions . Firms that are serious about exporting must hire staff with competency in international transactions and foreign languages.

Exporting is much more sensitive to tariff and other trade barriers and fluctuations in exchange rates.

Many of the pitfalls associated with exporting can be avoided if a company hires an experienced export management company, or export consultant, and if it adopts the appropriate export strategy. (Hill, 2009).

8. 0. CONCLUSIONS

Firms venturing abroad for the first time usually use exporting as their mode of entry. Exporting is also the entry strategy most favored by small and medium-sized enterprises. But beyond initial entry all types of firms, large and small use exporting regardless of their stage of internationalization. Exporting is the entry strategy responsible for the massive inflows and outflows that constitute global trade. Exporting typically generates substantial foreign exchange earnings for nations.

For example in the United States, SME's account for a great proportion of all U. S exporters. From 1992 to 2004, they represented nearly 100 percent of the growth in the U. S exporter population, swelling from about 108, 000 firms in 1992 to over 225, 000 firms by 2004. SME's were responsible for nearly a third of merchandise exports from the United States in 2006.

(Cavusgil, Knight, Riesenberger).

9. 0. RECOMMENDATIONS

Since it is possible to use both direct and indirect exporting simultaneously in different target markets, my recommendation would be to apply either direct or indirect exporting depending on the target markets and the conditions that prevail in those markets. Both methods of exporting can be used successfully.