LINKS AND COORDINATION

<u>OBJECTIVE:</u> This module shows the pivotal importance of links and coordination in the export business. It shows why they are more critical in exporting than they are in purely domestic businesses. It also shows:

(1) what the various linking and coordinating mechanisms are;
(2) how to set them up initially;
(3) how to review them;
(4) how to modify them over time so as to benefit the exporter;
(5) how to establish two-way communication through them;
(6) how to use them to control other participants, raise and stabilize profits.

<u>KEY CONCEPTS:</u>

1. Importance of identifying all the actors in the system, and knowing what each one brings to the business, and needs or expects to receive in return.

2. Importance of allocating time to analysis and choice of links and coordination measures adopted.

3. Importance of maintaining links and coordination through constant review of contractural arrangements, regulatory developments, competitive conditions, changes in consumer preferences, and performance of middlemen.

4. Possibility and desirability of achieving vertical balance through contractual integration.

5. Possibility of managing the links and achieving change in the balance of power so as to benefit the exporter - e.g. shift from consignment sales to guaranteed price sales, forward integration (partial or complete) into target countries, control over wholesalers, influence over price and product differentiation strategies.

METHODOLOGY: All the points to be covered in this module can conveniently be illustrated in clear and understandable fashion through a sequence of five case discussions. Following each case discussion a short handout will be given recapitulating the key points covered in the session.

Session 1. The naive approach

The exporter or would-be exporter in this case pays no attention whatever to management principles such as market analysis, linkages, communication, coordination, cash flow forecasting, etc. He computes (very crudely) that he has a tremendous cost advantage, i.e. that his landed price in the target market will be less than one-third the prevailing retail price in the target market. The product which he is exporting is apparently (but not really) identical to the one he is expecting to undersell. After a very cursory search he finds a broker in the target market who agrees to handle the merchandise on consignment, and to find a wholesaler who will handle the product. The broker will subtract his fees from the payments he will send the exporter after selling the merchandise. The exporter, after a similarly cursory search, finds a transportation company which agrees to send his product to the broker's warehouse.

The exporter sends a shipment. To his surprise, sixty days go by, and the shipment has not arrived. The exporter sends a second shipment, and a third. These arrive after only 45 days each, but the broker says he is unable to sell the merchandise at any price. Six months after the first shipment the exporter has yet to receive a dime from the broker. He is in considerable financial difficulty and cannot pay his mounting telephone bill. He begins to distrust the broker and is finally forced to abandon his potentially profitable export business.

KEY POINTS:

Session 1:

1) Cost advantage, no matter how overwhelming it seems, is only a prerequisite for success in exporting. It is by no means a sufficient condition. Without careful and competent management of linkages and coordination, no cost advantage is sufficient to translate into profits.

2) To a naive observer, the export business looks like a zero-sum game: the broker earns what the exporter loses. The correct view is that the cost advantage can translate into attractive profits for everyone involved, and the consumer can benefit as well. Management is what determines the size, persistence, and distribution of these gains. If any participant in the export process experiences losses or negative cash flow, the process stops, and no participant earns any more profits from the flow. If any participant takes on a disproportionate share of the risks and receives less reward than he deserves, the system is unstable, and likely to break down. Some participant must take the initiative to reallocate the risks or rewards so that they are equitably distributed.

3) It takes more than one active party to start an export business. One prime mover cannot succeed on his own no matter how many passive collaborators he has. This is a key difference between export businesses and purely domestic businesses. In a purely domestic business the lone entrepreneur can succeed, using only employees who are working for fixed compensation. In exporting, there must be several parties who have a stake in the outcome, who see this particular export venture as their vehicle to financial success and to accomplishing their personal goals. They must be located in both countries, and they must be able to take initiative, respong to emergencies, and make personal sacrifices as circumstances may require. It is a key factor in setting up an export business to assemble a group of people who take this attitude to toward the venture. The relationship among them can be contractual, or it can be a partnership or a corporation. The terms of the arrangement (who does what, who gets what) and the degree of commitment to it matter more than the form of association among them.

Session 2. First glimmers of enlightenment

In this case the exporter takes a slightly more managerial approach to the matter of setting up links and coordination. He succeeds in only the slightest degree -- for example, he identifies the wholesaler who agrees to buy the product (on terms net 60). This tiny improvement allows him to translate his overwhelming cost advantage into a paper-thin operating profit. If cash flow problems do not bankrupt him, he staggers along to the next level of sophistication.

KEY POINTS:

Session 2:

1) Any managerial improvement which the exporter makes vs. the naive approach will raise the probability of a successful and enduring venture. Improvements might include investigating the target market, identifying wholesalers, comparing brokers before choosing one, preparing cash flow projections, arranging working capital in advance, etc.

2) The really important task is to assemble a team, with members in the country of origin and also in the country of destination. The members of this team must be proficient in their specializations, but more importantly they must be motivated and committed to make the venture a success.

3) It is important to keep reviewing the risks and rewards which each member of the export team takes and receives. This way the exporter will be on the lookout for ways to reduce the risks and raise and stabilize the rewards.

Session 3. A marginally profitable arrangement

In this case the exporter has survived the initial setbacks and has devoted some attention to linkages and coordination. He has some idea of the segments of the target market to which his product sppeals. He has some grasp of the possible ways of reaching them, and an idea of the role each participant in the export business plays in reaching them. He does not have a very precise view of the risks, costs or returns which the other participants experience. He thinks he assumes the greatest risks, and earns thelowest return on investment of anybody involved. He feels that the other participants' returns are higher because they take advantage of him. He earns some profits, but comes nowhere near achieving the volume or profit performance which is attainable.

KEY POINTS:

Session 3:

1) Success in exporting requires more than knowledge of the production process and local conditions. The exporter must also understand the export paperwork process, transport conditions, economic and political conditions in the target market, and the idiosyncrasies of marketing channels in the

target country. This knowledge may be gained over time, in the course of doing buiness. The application of it will have a very strong impact on profit performance.

2) The exporter must understand the business of each participant in the entire export process, all the way to the retailer who sells the export product to the final consumer. Without this knowledge the exporter cannot obtain a very precise estimate of the costs, risks and returns associated with each phase of the business. With this knowledge, the exporter can spot where he has leverage and bargaining power, can see ways of improving the position of each member of the exporting team, and in this way can improve his own profitability, as well as the profitability of his partners.

3) As long as the exporter's understanding of all the phases of the business is incomplete, he will perceive inaccurately what the risks and returns are for each participant in this process. This inaccuracy will prevent him from being able to negotiate successfully for improvements in linkages and coordination.

Session 4. A somewhat successful company

In this case the exporter does several things well: he selects a product line in which he has a true cost advantage (not dependent on subsidy); he delivers consistent quality and sufficient volume; and he assembles a capable team of four good people (local production supervisor, local logistics and shipping supervisor, target country import specialist, and target country marketing manager). But he does not do everything well. He either fails to make good use of government assistance, or fails to perceive changes in the environment as they occur, or fails to perceive their impact on his organization. In any event, he encounters some difficulty. His business is more profitable than any of the first three, but is facing declining or negative profits at the time of the case.

KEY POINTS:

Session 4:

1) Once an export business is set up correctly, with proper links and coordination, profitability will increase rapidly. The company will be able to start producing and exporting other related products.

2) No arrangement remains stable for very long. The business's success attracts imitators. Also high profits are visible to everyone within the business. This visibility may require a reallocation of responsibilities or profits among the partners.

3) Success leads to large size, which in turn attracts

government attention. Local government officials or target country government officials may become interested in the business.

Session 5. A successful company

This exporter does yet more things well, for example, enlists local government assistance (of the type the government is suited to provide) from the beginning, or spots changes in the environment and reacts to them promptly. At the time of the case, several threats are emerging.

KEY POINTS:

Session 5:

1) Success gives management some breathing room. This should be used to analyze trends and threats which may be emerging.

2) Export businesses can be extremely profitable, but they attract many imitators very quickly, and they also attract government attention. The period of high profitability may not last very long.

3) To obtain help in dealing with foreign governments, it is adviseable to obtain local government support at an early stage. This may require some modification of links and coordinating arrangements.