5 The Export Transaction

If you have decided to proceed into direct exporting, it is now time to assemble a resource library and a team to assist you in export development leading to sales. *The Basic Guide to Exporting* is a must have item. It can be downloaded from http://www.export.gov. It is a concise publication with descriptions of export steps, terminology, and most of the forms you will need to negotiate and close the sale, as well as to complete the shipping documents. The guide also has a listing of INCO terms (see Chapter 6, Financing). Your export team—aside from in-house staff—should include an international attorney, a freight forwarder, a banker and an advisor from the USEAC, SCORE, SBDC or a mentoring export company, perhaps even an engineer from the Manufacturing Extension Partnership. You will need all of them to get your product ready, develop pricing, respond to inquiries, prepare quotations, negotiate sales, prepare shipping documents, and select the best form of payment.

Getting Your Product Export Ready

To successfully market a product in a foreign country, the manufacturer must incorporate industry standards, correct labeling, consumer preferences, and other consumer-driven considerations into a marketing strategy. In many cases, only a minor product alteration may be required to successfully gain appeal; in others, technical modifications must be made to incorporate standards of the importing country.

Consideration also should be given to the product name (i.e., it may inadvertently have a negative connotation in the local language), cultural and/or religious connotations, packaging and, most importantly, compliance with standards (i.e., different electrical power systems, metric dimensions and local product regulations). The EC mark, for instance, is required for products entering European Union countries; stringent labeling standards apply to food, supplements and cosmetics in most countries.

Another consideration when planning a market strategy is understanding the ramifications of ISO 9000 (www.iso.ch/iso/en/ISOOnline.frontpage), essentially a quality control/management system. When competing for business in foreign countries, particularly with regard to procurement bidding, it may be a requirement to be ISO certified. In many instances, subcontractors supplying parts or services for major overseas contractors are required by the terms of government contracts to be ISO 9000 qualified.

The purpose of the ISO 9000 series is to document, implement and demonstrate the quality assurance systems used by companies that supply goods and services internationally. ISO standards are required to be reviewed every five years. Additional information on these revisions can be obtained from the American Society for Quality (ASQ) at www.asq.org. For local help in quality control and manufacturing efficiency issues, contact the Manufacturing Extension Partnership, a joint effort of the National Institute for Standards and Technology (NIST) and State governments.

ISO Certification

There are three ways for a manufacturer to prove compliance with the requirements of one of the ISO 9000 standards. Manufacturers may evaluate their quality system and self-declare the conformance of the system to one of the ISO 9000 quality systems. Second-party evaluations occur when the buyer requires and conducts quality system evaluations of suppliers. These evaluations are mandatory only for companies wishing to become suppliers to that buyer. Third-party quality systems and evaluations and registrations may be voluntary or mandatory and are conducted by persons or organizations independent of both the supplier and the buyer. Interpretations of an ISO 9000 standard may not be consistent from one registrar to another.

Since the supplier's quality system is registered, not an individual product, the quality system registration does not imply product conformity to any given set of requirements. The demand for ISO 9000 registration in Europe and elsewhere appears to be coming primarily from the marketplace as "a contractual rather than a regulatory requirement." Additional information on U.S., foreign and international voluntary standards and government regulations and rules of certification for nonagricultural products is available from the National Center for Standards and Certification Information (NCSCI), which is part of the National Institute of Standards and Technology (NIST).

National Institute of Standards and Technology (NIST)
E-mail: inquiries@nist.gov
www.nist.gov

Global Standards and Information Group

National Institute of Standards and Technology (NCSCI)
E-mail: ncsci@nist.gov

Pricing

Pricing products for maximum competitiveness in foreign markets can be a challenge. Pricing that works in one market may be totally noncompetitive in another. Although there is no one formula, there are a number of strategic and technical considerations you can make to determine an appropriate pricing structure. At this point a number of questions need to be answered. For example: Are you entering the market with a new or unique product? Are you selling excess or obsolete products? Can your product demand a higher price because of brand recognition or superior quality? Are you willing to reduce profits to gain market share for long-term growth? Your pricing strategy will be affected by your company's business goals.

As part of your market research, obtain as much information as possible on local market prices. Pricing information can be obtained in several ways: a) from overseas distributors and agents of similar products of equivalent quality; b) whenever feasible, traveling to the country where your products will be sold to gather pricing information; and, c) through the U.S. Commercial Service which can assist in determining appropriate prices through its *Customized Sales Survey*. For more information, go to www.export.gov/tic. Check also with international business advisors (at the SBDC or State economic development) on assistance in developing your products' "landed cost" as a basis for developing price quotations.

Methods of International Pricing

The cost-plus method of international pricing is based on your domestic costs, plus additional exporting costs associated with international sales and promotion, product modification, etc. (Remember, costs associated with insuring or delivery are usually "pass-through costs" that do not have a mark-up component in arriving at a selling price.) Any costs not applicable, such as domestic marketing costs, are subtracted from the overall cost prior to mark-up to arrive at your selling price. The cost-plus method allows you to maintain your domestic profit margin percentage, and thus to set a suitable price. This method does not, however, take into account local market conditions.

Different marketing costs and/or modifications to the product could change the cost basis dramatically, making the product either more or less costly for export. As a result, using the "marginal-cost" method provides a more realistic means of determining true cost of producing your product for export. To use the marginal-cost method, first determine the *fixed costs*, if any, of producing an additional unit for export. Fixed costs are defined as costs that occur whether or not the company is selling anything, i.e., mortgage payments on land or buildings. If a company is operating at a profit, and additional assets are not being employed, fixed costs have been covered. At this point, any additional costs of producing products are termed *variable costs*.

There may be instances where additional assets are not needed to meet international sales requirements. In this case, the company would generally only be concerned with variable costs, operating expenses, taxes and net profit in determining the product sales price.

A company may have to purchase new machinery to meet international sales demands. Obviously, there would be a fixed cost component to international production costs (fixed costs would consist of amortized payment of the equipment). In this case, a fixed cost component must be included in the above example to reach the product sales price. International expenses may include the following:

Packaging

Local regulations and customs may require special labeling, translated instructions or different packaging to appeal to local tastes. The selected mode of distribution may also require a particular kind of packaging.

Foreign Market Research

Fees may be associated with specialized research and other educational services used to obtain market information.

Advertising and Marketing

Firms selling directly into new markets will most likely be responsible for the entire promotional effort, and may incur high initial outlays to establish product recognition in the new market. If an agent, distributor or trading company is employed, they typically can handle advertising and marketing as part of their contract.

Translation, Consulting and Legal Fees

Product instructions, sales agreements and other documentation generally will need to be translated into the local language. Be aware that idioms and words can differ greatly in regions using the same language. Expert translation of product labeling and instructions is essential. Although many sales agreements are standard, it is advisable to have legal counsel to review all binding documents.

Foreign Agent/Distributor Product Information and Training

Agents and distributors may require special training to effectively market and service your products. This is true even if the agent sells similar products. Training will not only enable the agent to better represent your company’s interests, but gain a better understanding of your product.

After-Sales Service Costs

Product warranties and service contracts will enhance your product's image. An appropriate after-sales service guarantee can support your sales effort in the new market. Do not, however, promise service or warranties based on U.S. standards that you cannot deliver. After taking these expenses into account, insurance, freight, duties and a profit margin can be added to arrive at a customer price. Depending on the country, currency fluctuations can significantly affect profit margin and the final price. New-to-export companies should price products in U.S. dollars and request payment in dollars.

High-Price Option

This approach may be appropriate if your company is selling a new product, or if you are attempting to position your product or service at the upper-end of the market. Selecting this option may attract competition and limit the market for your product while producing large profit margins.

Moderate-Price Option

This is a lower risk approach as compared with the high- or low-price option. Here you should be able to match competitors' prices, build a market position and produce reasonable profit margins.

Low-Price Option

This approach may be relevant if you are trying to reduce inventory, want to quickly establish a market presence, or do not have a long-term commitment to the market. You will, no doubt, impede competition but also produce low profit margins. Overall, no single strategy is ideal for every company. As a result, companies often draw upon a mix of options for each market or product.

Setting Terms of Sale

Price Quotations

The pro forma invoice is the most commonly used document to give price quotations to potential customers. If both buyer and seller are in agreement, it is usually considered a sales binding sales contract, although prices may change prior to final sale. To prepare the invoice, you should give a detailed description of the product and an itemized list of fees and terms of sale. Prices should be quoted in U.S. dollars to reduce foreign exchange risks. The invoice also should indicate the period during which the price quotation is valid, the terms and method of payment, and delivery terms.

You should be familiar with the common terms of sale used in international trade before preparing your pro-forma invoice. International Commercial Terms (INCOTERMS) are universally recognized in export and import contracts. These terms refer to the rights and obligations of each party (i.e., who pays what costs, when title to goods is transferred and where the goods should be delivered). A complete list of INCOTERMS published in the book *Incoterms for America* by Frank Reynolds can be obtained from the International Chamber of Commerce's (ICC) Bookstore, (www.iccbookusa.com/paag.cfm) and should be a permanent part of your business library.

Negotiating Sales and Distributor Agreements

Sales Contracts

Knowing how to include INCOTERMS in a contract is important, but it represents only one aspect of the sales agreement. Legal rights and obligations of the parties should be spelled out in a single document, which can be incorporated into the final invoice. Frequently, the terms and conditions are contained on the back of the invoice.

Some of the terms and conditions necessary in a written sales agreement include the following:

Delivery Terms—Risk of Loss
A *force majeure* clause is standard in most agreements. This clause excuses the exporter from responsibility where a default in performance is caused by events beyond the exporter's control, such as war, acts of God or labor problems.

Payment and Finance Terms
In addition to defining the terms of payment, provisions should be included for late payments, partial payments and remedies for non-payment. When discussing how to get paid, include the cost to your buyer of your preferred method of payment as one of your considerations. If you insist on wire transfer and the cost of this service is high in the export country, you are adding to the cost of your product. Optimize the negotiation process by offering to share fees, if the speed of receiving payment is important for your cash flow. Consider risk insurance protection for the for foreign receivable, if your competition is offering open account terms. See also Chapter 6, Export Financing.

Warranties
Sales contracts generally describe the goods and their qualities, workmanship and durability. In some cases, the exporter is obligated by the law in the country of import to provide quality and warranty information. Thus, the importer will require the exporter to warrant that the goods meet certain standards of construction and performance.

Acceptance of Goods
Frequently, the importer will insist upon the right to inspect the goods upon delivery. If found defective, the importer can reject them and refuse to pay. However, the importer is still liable for country-of-importation duties and other taxes. The export documents should reflect any such requirements. It is advisable to stipulate in the contract that the terms for buyer acceptance and preferences

for any inspections will be completed by a qualified third party, preferably before shipment.

Intellectual Property Rights
Protection of the exporter's patents, trademarks or copyrights should be assured in the agreement. However, protection under the laws of the foreign country is not automatic. You should not assume that your product is protected. Please consult with an attorney on the advisability and procedures required to properly register your intellectual property in specific countries.

Taxes
The obligations of the parties for payment of taxes other than customs duties should be defined in writing.

Dispute Settlement
It is advisable to specify how and where any disputes will be resolved, as well as which nation's law would be applied. Bear in mind that different countries have varying arbitration laws and systems, which may apply.

Agent and Distributor Agreements

If you choose to use an agent or distributor, it will be necessary to develop a formal contractual agreement. Agent and distributor agreements spell out in greater detail the issues noted above and define other aspects of the relationship between the parties to the agreement. In the contract it is important to:

1. Specify the goods and/or services covered.
2. Describe the agent or distributor's sales territory, and whether they will have exclusive or non-exclusive sales rights.
3. Set the length of the term for which the agreement is applicable and agree upon specified minimum sales volumes and objectives.
4. Outline protection of intellectual property.
5. Describe other types of obligations imposed on the parties, violations of which would justify termination of the contract.
6. List specific intellectual property rights granted to the agent or distributor.

When negotiating and drafting contractual agreements, it is recommended that you consult an attorney with experience in international trade and laws of the specified country. Your local bar association may provide a referral service. Under agreement with the Federal Bar Association and the U.S. Department of Commerce, the Small Business Administration sponsors the Export Legal Assistance Network (ELAN). ELAN is a group of attorneys throughout the United States who specialize in international trade. Your local Commercial Service office, international SBDC or U.S. Export Assistance Center (USEAC) can assist in locating an ELAN attorney who will provide a free, initial legal consultation to discuss your export-related questions.

Terms for financing export sales should be discussed during contract negotiations. While the U.S. seller will want to be paid as soon as possible, the foreign buyer will want to delay payment as long as possible, preferably until after the goods are resold. These two conflicting objectives will factor into any negotiations on export financing. In addition to reaching a compromise on the method of payment, the U.S. exporter must also be able to offer the foreign buyer favorable financing terms—otherwise the sale could be lost to a foreign competitor with an equivalent product but better payment terms. The final step in completing the export transaction is arranging for payment, the subject of Chapter 6, "Export Financing."