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A Secret Weapon to Increase World Trade

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SPECIAL REPORT:

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Perestroika and glasnost have forever changed the way business is conducted in the Eastern Bloc countries. A more open society and the beginning of a free market system will offer unparalleled opportunities to U.S. industries hoping to develop new markets in the Soviet Union and Eastern Europe. Despite this remarkable change, however, some difficult hurdles remain when concluding business deals in that part of the world.

Capital goods and system technology are desperately needed by the Soviet Bloc to better prepare their industries for consumer goods production. But a shortage of convertible Western currencies to pay for the needed changes is one of the major obstacles in consumating what could be very lucrative deals. Money — in the form of convertible currencies — is generally not available to Eastern Bloc buyers. And an artificial exchange rate, set by the government, bears no resemblance to the real value of the currency — which makes it unacceptable to the Western supplier.

Rather than dismissing new business opportunities because of this currency impediment, there are unconventional ways to develop initial business with the COMECON nations (The Council for Economic Cooperation unites the Soviet Union and the other evolving Communist countries, excluding China.) And they can pave the way to solid and long-lasting business relationships.

Countertrade is one of the best ways to gain a foothold in these markets. Although it seems to violate the basic premise of free trade — by trading goods against goods — industrialized nations with a free market system are making more and more use of its possibilities. The export-oriented countries of the West — notably West Germany and Japan — often use it as means of securing financing for their exports, developing difficult markets, and strengthening their competitive standing in world markets.

And in the Eastern Bloc countries, where foreign debt, trade deficits, and protectionism have reached alarming proportions, countertrade as a means of international exchange of goods has helped foster economic development. Countertrade may sometimes prolong inefficient economic structures, but without this means of exchange, many deals ultimately leading to strengthened industries in developing economies — and giving participation incentives to Western concerns — would not be possible.

Countertrade can be divided into three major categories:

- Parallel trade
- Barter trade
- Buyback trade

Parallel trade. In parallel trade, the exporter draws up a contract detailing the payment terms of the order. In a separate, parallel contract, terms and conditions for the exchange of goods are stipulated. One reason for this separation is that payment or credit arrangements are handled independently from countertrade requirements. Only because of this separation can the agreement be insured by applicable credit insurance companies to cover the exporter in case of default by the customer.

U.S. firms hoping to stay competitive must explore countertrade's possibilities in order to keep pace with other sophisticated world traders.

Apart from the brokerage conditions, the most critical item in a countertrade agreement is the kind of goods that have to be taken in return. The tendency in recent years has been for the supplier to specify certain goods in the countertrade agreement. But the fixing of prices for these products can lead to difficulties later on when trying to dispose of the goods. It can also lead to sharp profit reductions, resulting in unforeseen losses. It's therefore highly advisable to assure the recipient that no specific goods will be taken in return.

Specific goods are normally those that the supplier cannot dispose of himself. Exceptions are goods that can be used within the company, or goods sold through the company's own sales channels, which requires knowledge of markets and products. This is especially important since the offered goods can often be of a quality unacceptable to Western customers.

The purchaser of the Western goods is not always the seller of the countertrade goods. In this case, the Western importer can buy from a different state entity in the COMECON country. The importer in the West then receives a confirmation from his COMECON supplier that goods at a certain value have been bought and paid for and that they will be used to fulfill the U.S. exporter's countertrade obligations. However, this must conform to the conditions of his contract and be acceptable to the purchaser. The Western importer then gives this purchase confirmation to an export service company, which forwards it to the COMECON exporter. You, the exporter, in turn must give this confirmation to the purchaser, who must accept its conditions. After receiving the acceptance, the COMECON exporter must pay the commission previously agreed upon with the export service company. The company will then pay the commission, reduced by the agreed upon margin to the U.S. exporter.

Barter Trade. Bartering — exchanging products for products — is the oldest form of trade. With it, products are exchanged against products. Once an agreement to exchange products is concluded, no billing or exchange of money takes place.

While bartering agreements are usually concluded between exporter and importer, compensating trade agreements normally include a third party — often an export service company intimately familiar with what goods sell where and at what price.

One of the major risks in barter trade, however, is the difficulty in checking the products before shipment. To circumvent this problem, several solutions satisfy the requirements of both sides:

- An agreement can be reached with the COMECON partner to ship his products first. After accepting the products, you can release his ordered shipment. To accommodate the COMECON importer, you should allow him to inspect and accept the products he ordered at the source in the West.
- To offer the COMECON importer some piece of mind, an agreement can be reached to deposit profits from the product sale into an escrow account. In the case of a barter arrangement, this would be the agreed-upon amount in Western currency — similar to a letter of credit in normal cross-border transactions. The deposited amount is then available to you upon presentation of mutually agreed-upon documentation for the goods or services sold.
- Sometimes the contractual goods can't be delivered by the COMECON country at the same time the shipment of products from the Western exporter is ready. But there is a means of safeguarding the interests of the Western exporter. On behalf of the COMECON buyer, a bank guarantee can be established in the COMECON country. This guarantee can be utilized if the buyer doesn't ship his goods or doesn't supply them as stipulated in the agreement.
- When only a portion of the exporter's delivery value is covered by supply of goods from the customer, it is referred to as partial compensation. The balance of the contract value can be paid for in convertible currency, or settled with partial payments via a bank guarantee by the COMECON country.
- If the exporter doesn't have or can't find opportunities to dispose of the COMECON goods, he can make good use of a third party, with connections to the COMECON country. The group, often named by the COMECON importer, should be able to dispose of the goods or services expediently.

Buyback Trade. In this form of countertrade, the Western company sells the

The Joint Venture Alternative

Recently joint ventures between many Western countries and — most notably — Soviet and Hungarian state entities have received a good deal of attention. German companies, in particular, have shown a strong commitment towards this type of business. Agreements with the COMECON nations have been concluded in record numbers, and many other Western European and U.S. companies are making inroads via the joint venture route.

Joint ventures are often seen as the best vehicle to enter these emerging markets. But the euphoria surrounding them is slightly overblown. Time and energy consuming, they take companies down the long road to success. Years may pass before noticeable revenues and profits are realized. Consider joint ventures only after thoroughly investigating your business partners in the Eastern Bloc. Just like international business in general, a basic knowledge of and appreciation for the differences encountered in a centrally-planned economy are a must for successful cooperation.

COMECON client a complete factory, a production line, a license, know-how, or technology. Payment is made in full or in part by products manufactured on the production line, or in the factory supplied by the U.S. exporter. The products supplied are used to amortize the purchase price of the capital goods or technologies. Should supply difficulties arise, or should the COMECON customer fail to meet his obligations, the Western exporter can be covered by a bank guarantee in the COMECON country.

The Western exporter is usually the builder of the manufacturing facilities where the goods are to be produced. And delivery times can be long, so insist on downpayments and progress payments customary to the industry.

You must agree to take products manufactured on your equipment for a value equivalent to your shipments. Added to this amount is interest accrued during the financing period. Financing is often requested for 10 semi-annual periods. Amortization, including the accrued interest, is to be secured by the goods to be supplied by the COMECON purchaser. Understandably, you can't accept such conditions blindly. Careful evaluation is crucial.

Because the transactions usually involve millions of dollars, you should first conduct a thorough market study to determine whether the goods offered have realistic sales potential in the West. Also contact a reputable international trading company or broker willing to market the goods, and secure five-year financing.

The Evolution of Countertrade. Recent developments, led by the movement to create a free market economy in the Soviet Union, have given many state enterprises the chance to conclude agreements. Rather than going through the bureaucracy of foreign trade ministries, they can now deal directly with Western companies.

However, the purchaser has to generate his own foreign capital required for the transaction by selling goods from his own production to the West. If such cases become successful and move these companies out from under the centralized bureaucracy, the process of countertrade, and — in time — more conventional forms of trade, will be greatly facilitated.

Countertrade is extremely complex. Success requires a detailed knowledge of East-West business dealings and a thorough investigation of potential opportunities. But the growing demand for goods and technology in the COMECON countries will make this alternative form of trade even more competitive in the next few years.

Even now, 50% of total worldwide countertrade is conducted with the COMECON nations. U.S. companies hoping to stay competitive in the "new" world — with its fast-changing Soviet Bloc economies — must explore countertrade's possiblities to keep pace with other sophisticated world traders. ET

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Rather than dismiss new business opportunities because of currency impediments, there are unconventional ways to develop business with Eastern Bloc nations in desperate need of capital goods and system technology.

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