Accounting for management

Is exporting right for your company?

An alignment of economic factors may make exporting feasible for smaller firms

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DESPITE THE RECESSION, SOME BUSINESSES are picking up, climbing back to pre-recession levels. Other businesses are looking to grow further. One potential growth area is selling products or services internationally. For some electromechanical service businesses, it may be an untapped market.

This may sound strange, as lately imports have dominated the headlines. In addition to foreign competition, U.S. companies have built foreign operations. Many industries, including apparel sewing operations, went offshore during the past decades. The current trend seems toward higher-skilled manufacturing and even services making the move.

Although certain types of high-volume, repetitive manufacturing are at risk, most small businesses have niches that insulate them from this risk. The niches include engineering expertise, customization, and service, among others. The niches make these companies invaluable to their customers. The same unique features can make them good candidates for exporting.

From a service perspective, service businesses have much to contribute as well. From preventive maintenance programs to configuration of new facilities, consultants with the right background are in demand. Their expertise can provide many insights for those plants in other countries.

Not only can exporting generate sales, but it also offers significant tax advantages. Under the Extraterritorial Income Exclusion Act of 2000, from 15% to 30% of income from exports can be excluded from U.S. taxation. Also, companies that pay duty for imported items can apply to receive a refund as those items are exported. Certain international markets stand out. The top countries for U.S. exports include Canada, Mexico, Japan, Britain, and Germany.

Direct entry

Some companies choose, sometimes to their detriment, to attempt to enter markets directly. Establishing an infrastructure in a foreign country can be extremely expensive. In addition, the typical costs and risks associated with start-ups are encountered. This means months and months of burning cash until operations reach break-even.

In addition to these costs, foreign receivables also carry risks. Credit information regarding foreign companies is extremely limited compared to what is available to local U.S. companies. Often, lenders will consider these receivables as ineligible for purposes of borrowing base calculations and thus not allow them to be financed. Other lenders will finance them, but only after the borrower obtains expensive credit insurance.

More conservative approaches to extending credit might call for payment in advance or bank guarantees. Until recently, much international trade involving smaller companies was done under those terms. Cash in advance is the safest solution for the exporter but is unlikely to be acceptable to foreign companies that are well established in foreign trade. The next best thing is letter-of-credit security, under which the customer's bank pays the seller's invoice upon presentation of shipment documentation.

A somewhat less extreme form of payment is trade acceptances. These are time drafts payable after an agreed upon period, guaranteed by banks. It adds a payment terms element to the letter of credit approach. Trade acceptances were a very popular way of doing business until recently. Although they are still used, many companies have converted to normal accounts receivable terms.

Moreover, the framework for doing business abroad can be negative. The local bureaucracies of foreign governments are often difficult for U.S. businesses. Paperwork may abound and take much time for the government to process. Foreign legal systems vary in their biases. The U.S. court system is without consequence.

When added together, the risks of underutilized investment in building an infrastructure, of non-collection, and of unfavorable fluctuation in foreign exchange is enough to keep many companies out of investing in foreign markets directly. If things go badly, the effect on the company could be devastating. Fortunately, for those just starting, there is an alternative.

Indirect approach

Unlike direct investment, an indirect approach carries less risk. Some of the inevitable uncertainties are minimized. Going indirect means the exporter would engage distributors, sales representatives, or other intermediaries in entering foreign markets. The use of these intermediaries greatly reduces the risk of trading internationally. The risks relating to infrastructure, collection, and foreign exchange are all borne by the intermediary. It is a means for U.S. companies to enter markets with minimal investment.

With the availability of the Internet, locating these partners is not as difficult as it once was. A company might start with its current distribution customers, and see which ones sell internationally. Trade shows and associations are also good sources. A company might also contact the U.S. trade offices, including the U.S. Bureau of International Commerce (part of the U.S. Department of Commerce, Washington, D.C. 20230).

These intermediaries will represent your products on a commission basis. As they collect money for sales, a designated portion of the receipts goes to the intermediary, with the rest directly to the seller. This type of arrangement has no volume risks. Under a commission approach, no matter how low the sales, each dollar contributes income.

The risk, however, is in entering into an exclusive relationship with the wrong company. The exporter must scrutinize the intermediary enough to assure it can perform. Ideally, the company would already be successful and enjoy a strong reputation locally. It should be financially secure and independent. It should also have a record of accomplishment in dealing with foreign partners.

Another downside with intermediaries compared with selling direct is that they do not exclusively represent a single company's product. This makes it a challenge to assure that they are applying adequate marketing efforts. ■