
STRATEGIC USE OF COUNTERTRADE IN MULTINATIONAL BUSINESS

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Countertrade, a generic name for various types of non-cash or partial cash trading, has increased in volume in the world trade. This article deals with recent countertrade developments and offers a new conceptual framework which denotes how multinational managers can use countertrade as a strategic tool.

The trend toward countertrade has stimulated considerable interest among both managers and academics. In practice, countertrade may take various forms, including barter, bilateral agreements, switch, counterpurchase, offset, and compensation. Table 1 provides definitions for each of these terms. From the standpoint of international firms, counterpurchase, offset, and compensation trading are considered the most vital transactions.

Traditionally, countertrade has been associated with East-West trade ([7],[12],[16]). However, recent world economic developments have augmented its use by Third World countries as well ([5],[9],[11]). The major characteristics of present countertrade practices, which are summarized below, include the volume of countertrade, government intervention in international trade, the involvement of multinational corporations in countertrade, and the permanence of countertrade.

Characteristics of Countertrade

Volume of countertrade

Even though estimates vary, countertrade today represents a significant portion of the overall world trade. The U.S. Department of Commerce estimates that between 20 and 30 percent of world trade involves some form of counterpurchase, offset, or compensation, and it has been suggested that this share of the market could reach 50 percent in the next 15 years ([1],[6]). Survey results of the National Foreign Trade Council Foundation indicate that countertrade transaction have increased 50, 64, and 117 percent in the years of 1982, 1983, and 1984 respectively ([4],[6]). Thus, in the last decade, the volume of countertrade has surged from negligible to a considerable portion of world trade [10].

Governmental Intervention in International Trade

Governments have been interfering increasingly with international free trade to the point of mandating countertrade. Recently, the number of governments mandating countertrade has risen substantially. In 1982, Indonesia adopted a counterpurchase

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policy affecting all governmental procurement in excess of \$500,000. Additionally, Iraq prevailed upon foreign suppliers to accept payments in crude oil at official prices, while a 1984 governmental decree in Colombia requires counterpurchase or barter of Colombian goods in trade transactions involving private sector firms.

Table 1
Forms of Countertrade

Barter	Direct exchange of goods or commodities between two parties without cash payments.
Bilateral Clearing Agreements	Exchanging goods or commodities over a period of time by two governments. Types of products to be exchanged, prices, total values, and contract durations are specified.
Switch Agreements	Conversion of a bilateral clearing agreement into a multilateral one by permitting the country with a surplus in bilateral trade to make available to a third party a portion or all of its clearing account.
Counterpurchase	Acceptance of payments in counterdeliveries of goods that are not derived from or related to the original delivery. For example, PepsiCo supplied equipment and concentrates to Soviet Union and, in return, payment was made in vodka.
Offset	A special version of counterpurchase in which counterdelivery can be used in the business of supplier. For example, a western company sold aircraft to Ghana and agreed to receive manganese and bauxite to offset the sale.
Compensation	Buying back "resultant/related product" for the sale of plant, equipment, or technology. For example, International Harvester licensed Poland to produce earth-moving equipment and agreed to market one third of the output in the west.

Multinational Corporation Involvement

Traditionally, countertrade in the form of bilateral clearing agreements have occurred between governments. Recently, multinational corporations (MNCs) and international trading companies (ITCs) have also knowingly engaged in counterpurchase, offset, and compensation trades. For example, Occidental Petroleum arranged for the delivery of fertilizer plants and pipelines to the Soviet Union in exchange for ammonia. Douglas Aircraft sold its DC-9s to Yugoslavia in return for an agreement by Douglas to assist in marketing Yugoslavian goods. Such giant international trading

companies as Mitsubishi, C. Itoh, and Sumitomo of Japan are expanding their countertrade operations, and some American companies, including General Electric, Bank of America, and First Chicago, have established their own export trading companies.

Permanence of Countertrade

Countertrade has emerged as a result of economic difficulties experienced in Third World and Socialist countries. As long as economic problems prevail in these countries, such as mounting foreign debt, balance of payment deficits, trade deficits, and hard currency shortages, countertrade will probably be used as an alternative trade pattern.

In the past, Third World and Socialist countries have entered into counterpurchase, offset, and compensation arrangements to temporarily relieve the pressure of convertible currency shortages. Today's increasing balance of payment and foreign debt problems in these countries suggest countertrade will continue to be a trade policy in the near future. Brazil and Indonesia, for example, have adopted trade policies requiring counterpurchase, offset, and compensation trade in international transactions.

Given the increasing role of countertrade in international marketplace, a conceptual framework is needed to display the process of countertrade strategy formulation and implementation. Figure 1 presents such a framework.

Motives of Multinational Corporations

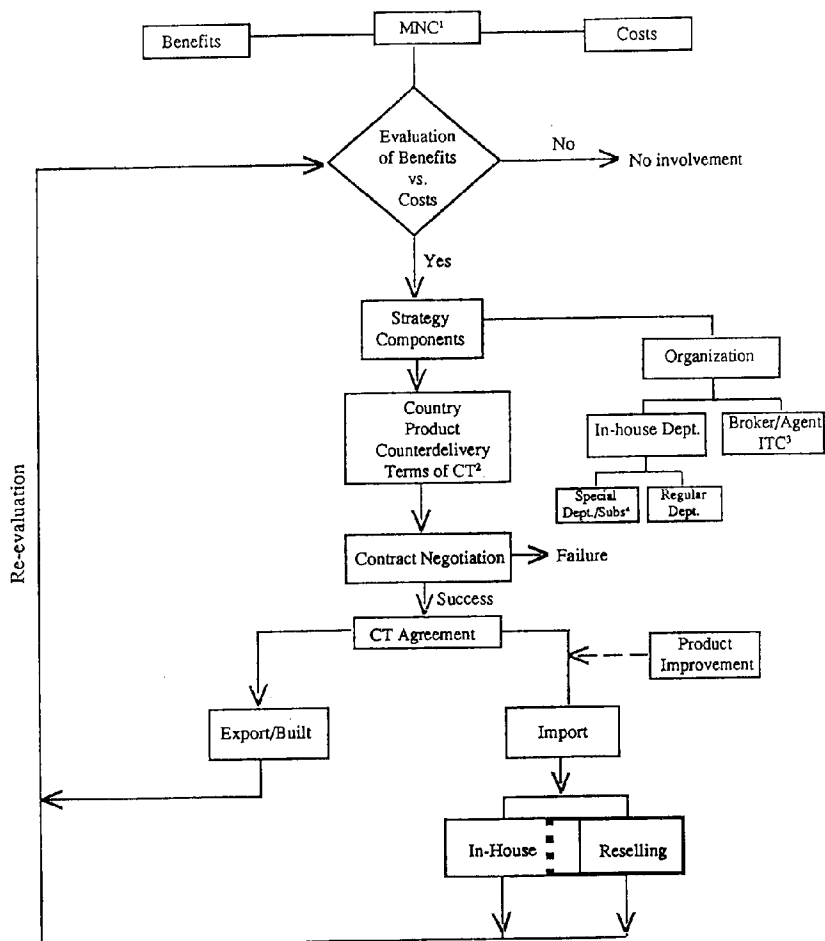
Although many motivating factors could exist for a MNC to be involved in countertrade, there are a few identifiable principal forces which appear to underlie their involvement in this activity. While not exhaustive, the enumerated list below provides an illustrative outline of motives which impact on their participation in countertrade.

a) *Market penetration and expansion is a significant incentive for MNCs to engage in countertrade.* MNCs practice countertrade to gain a competitive advantage against other international marketers. Yoffie [19] has suggested that countertrade is a profitable instrument for international firms. For example, Goodyear uses countertrade as a sales tool, trading its tires for minerals, textiles, and agricultural products. General Electric has reached \$4 billion in sales agreements through transactions involving countertrade. Coca-Cola, likewise, benefits from countertrade through its exploitation of two distinct market advantages – it is one of the pioneers in these kinds of operations, and it has an extensive worldwide marketing network. In order to sell Coca-Cola concentrate, the company has been involved in numerous countertrade arrangements, including the construction of a whey-protein plant in the Soviet Union, the planting of thousands of acres of orange trees in Egypt, and the exporting of soft-drink bottles from Hungary to Western Europe.

Supporting the development of countertrade, Mirus and Yeung [13] regard countertrade as a different mode of foreign market entry by multinational firms, in addition to conventional entry modes such as exporting, licensing, and direct foreign investment.

In this respect, Huszagh and Barksdale point out that "countertrade transactions support companies in implementing marketing strategies" ([8], p. 26).

Figure 1
Countertrade Strategy



- 1 Multinational Company
- 2 Countertrade
- 3 International Trading Company
- 4 Subsidiary

b) *Multinational firms can use counterpurchase, offset, and compensation arrangements as tools for global "sourcing"*. Global sourcing refers to procurement of raw materials and components, by international firms, in any part of the world for use in their production. Walsh [18] argues that firms source globally in order to ensure a stable supply of essential imports or to obtain the most competitive inputs for their operations. In different ways, Brazil, Algeria, Egypt, and India all encourage global marketers to engage in such arrangements. Commodities such as oil, coal, phosphate rock, metal ores, coffee, cocoa, jute, timber, rubber, wool, and beef are among the most frequently countertraded goods [15].

c) *Multinational firms may seek diversified expansion through countertrade*. Metallgesellschaft, the giant West German mining, engineering, metals, and trading company, engages in countertrade which now totals approximately \$250 million annually. Similarly, Louis Dreyfus & Cie, a French grain trader which has sales of \$10 billion, moved into countertrade to bolster its agricultural commodities trade ([17], p. 32).

The Japanese consortium of Showa Aluminum Co. Ltd., Kobe Steel Co., Sumitomo Industries Limited, and Mitsubishi Metal Industries has engaged in a major compensation agreement with Venezuela. Under the agreement, the consortium acquired a 20 percent equity stake in a Venezuelan aluminum joint venture and agreed to buy back 170,000 metric tons of the aluminum produced.

d) *Competitive advantage in international bids is a specific, common reason for MNC involvement in countertrade*. Although it could be considered a factor in any of the previous motives, it is important to emphasize the role of competitive advantage because it can provide significant strategic advantage for a MNC. For example, "(General Electric) won a bidding war for \$150 million electric generator project in Rumania against Hitachi and Siemens, among others, not because of a major technological or cost advantage but because it agreed to market \$150 million worth of that country's products" ([19], p. 8).

Since public agencies in Uruguay prefer foreign procurement bids with countertrade option, international firms try to include such offers in their packages. Again, due to the Saudi government's persistent emphasis on compensation, a U.S. company won the contract to build a petrochemical plant only after accepting provisions involving buy-back and international marketing of some of the resulting products.

The Strategic Use of Countertrade

To become involved in countertrade, a multinational firm must first evaluate the potential benefits against potential drawbacks of this special form of international trade. The benefits expected from countertrade usually include a competitive edge for the company, effective global sourcing, optimal capacity utilization, growth in sales, enabling penetration to semi-closed markets (e.g. Chinese market), control of control and exchange problems, and disposal of declining products [14].

In contrast, countertrade is not problem-free as there can be major pitfalls. It can be riskier than cash trade, the transactions can be quite complex and costly,

the process is time consuming, the customer gains leverage, management exposes itself to a potential lack of knowledge about certain traits of both the customers and the markets with which it is dealing, and there may be difficulties in reselling counterdeliveries. A MNC should be aware of these pitfalls and assess the company's resources against them. If the benefits outweigh the costs and if the company's strengths seem to overcome those limitations, the company can pursue countertrade.

If the firm determines to become involved in countertrade, it must subsequently develop operational policy components of its strategy. These operational components include selection of country, export product, counterdelivery policies, and terms of countertrade agreement.

Country selection policies will determine which countries will be targeted for countertrading. These countries may range from Socialist and Third World countries to developed ones. "An evaluation of the country's economic and social conditions, political stability, legal systems, government regulations, and past performance in international trade and countertrade needs to be done to measure the suitability of the country as a potential countertrade partner" [3]. The country selection policy should also elaborate the company's position with respect to credit difficulties of countries under consideration. In this respect, it may focus on indebted Latin American countries. It should decide whether the company will pursue an active strategy of countertrade (offering countertrade packages) or a passive one (accepting countertrade proposals initiated by the counterpart).

Product policies should specify what products or services will be offered through countertrade. A company which enjoys a strong bargaining position on certain products can exclude those products from countertrade deals while it develops a list of other products subject to countertrade.

Counterdelivery policies must focus on acceptable counterdeliveries for trade purposes, considering types, amounts, and uses. The company may exclude certain type of products (for example, finished goods of poor quality) while accepting intermediate goods and raw materials as payment, or limit the acceptance of certain products (for example, oil in a glutted market).

Terms of countertrade agreement policies will, of course, refer to specifications on export products and counterdeliveries. However, they should also include such important information as contract duration, negotiation procedures, fines, delivery schedule, and dispute settlement.

To implement the countertrade strategy, the firm should also decide on an organizational arrangement. In this respect, it has simply two options. One is to conduct countertrade through an in-house department or subsidiary. Carter and Gagne point out the advantages and disadvantages of this option as follows:

Managing countertrade in-house provides the company with lower costs, greater control, increased flexibility in deal making, and direct contact with the partner. The in-house route has disadvantages as well: It requires closely coordinating several functional departments, training inexperienced personnel, and using scarce managerial resources. ([2], p. 35)

To use this alternative, the firm's potential countertrade volume should justify such an arrangement. In doing so, the firm can establish a special department, responsible for countertrade activities, or it can handle countertrade through a regular department. A special countertrade department should consist of staff knowledgeable in finance, marketing, purchasing, and legal functions. It would require extensive training of existing staff or recruitment of new specialists. For example, Coca-Cola has a special unit to handle countertrade functions. Another version of an in-house arrangement is the creation of a subsidiary trade company. Some companies, like General Motors and General Electric, employ trading subsidiaries which handle their own as well as others' countertrade activities worldwide.

A regular department handling countertrade provides a standardization in operations, but this imposes an additional burden on the unit in terms of learning the intricacies of countertrade. Despite the necessity of concerted efforts by various departments, one unit should be charged with the responsibilities of coordinating countertrade, such as the marketing or material management department.

Another option is to manage countertrade through brokers, agents, or an international trading company. This option relieves the company from the burden of dealing with the complexities of countertrade. However, this option could be a costly alternative since an outside intermediary might overlook the long-range interests of the company.

Countertrade agreements involving complex and long-lasting negotiations require an experienced staff to construct the components as well as define details of contracts. Therefore, the negotiators should be selected carefully and be delegated with the authority to make instantaneous decisions. The company staff should be especially prepared for tough and experienced negotiators representing Socialist bloc countries. Clearly, the countertrading firm should train its staff carefully in the complexities of countertrade so that these negotiators can handle countertrade effectively.

After successful negotiations to reach an agreement, the firm meets its commitment by exporting the designated product or by building a facility in the host country. In return, it receives counterdeliveries. However, the company should be aware that delays in scheduled deliveries or products of inferior quality are not uncommon, given the conditions in Socialist and Third World countries. It might be necessary for the firm to provide some initial means of product improvement for its partner to avoid poor quality of counterdeliveries later. For example, in order to improve the quality of Yugoslavian wine, Coca-Cola made special arrangements to advance the Yugoslavian technology through the assistance of a third party. Of course, such an attempt entail additional costs which should be incorporated in the initial strategy development and, ultimately, in the countertrade agreement.

The outcomes of countertrade deals, as well as their impact on the firm, should be provided as feedback in the strategic management process. A continual re-evaluation of the situation should assist in determining whether to continue, to modify, or to discontinue the firm's present countertrade strategy. One consideration which must be addresses at this level is the distribution of unusable counterdeliveries, which may

be resold in domestic or global markets. For unfamiliar counterdeliveries – products not in the usual business of the firm – the firm must find buyers.

Strategic Implications

After introducing countertrade strategy components and process, the strategic implications of this special trading pattern require attention. If the present global and national economic conditions prevail, Third World and Socialist countries will continue to demand countertrade as a way of exchanging goods and services in the global market. From the standpoint of multinational firms, a sound strategy calls for timely responses to environmental opportunities. Consequently, multinational firms should consider countertrade strategies to take advantage of those opportunities. Therefore, it will be useful for international business managers to learn the dynamics of countertrade. In this respect, the following recommendations are made:

1. *Learn motives of the parties.* As described above, Third World and Socialist countries and MNCs have different motives. Thus, a party should evaluate the motives and interests of other parties at the early stages of negotiations. The framework provided here can be used to identify and assess motives and the willingness of parties to engage in countertrade accords. This should assist the multinational strategist in determining under what conditions to use countertrade as an alternative technique.
2. *Gain competitive advantages.* The developments with respect to counterpurchase, offset and compensation trading suggest that these patterns will be one of the major international marketing forms in the near future. Third World and Socialist countries are willing to buy goods and services from multinational firms but cannot pay for them in hard currency. Under such circumstances, multinational firms can use countertrade as a feasible functional strategy. The firm extending a countertrade option to its Third World and Socialist customers will have a competitive advantage over firms not offering such deals. In addition to their conventional marketing techniques, multinational firms should employ counterpurchase, offset, and compensation trading techniques to be more competitive in the global market.
3. *Find an alliance.* Unlike conventional export sales, typical countertrade agreements obligate exporting firms to buy or market counterdeliveries. The exporter may need to market those counterdeliveries through another firm. Such situations require countertrading firms to seek partners, especially when counterdeliveries lie beyond traditional area of expertise. It is not always easy to find a third party readily available for such arrangements. Therefore, the firm should make a determined effort to locate domestic or foreign firms to jointly conduct its countertrade operations successfully and to build expertise in managing the intricacies of countertrade. As an example of this point, PepsiCo Inc. receives vodka in exchange for the beverage concentrates it sells to the Soviet Union. As

PepsiCo prefers to not sell the vodka itself, it has transferred the import rights to another company, Monsieur Henri Wines, Ltd.

4. *Be able to cope with problems.* Countertrading is a cumbersome process which requires the skillful handling of a variety of problems. Major problems experienced with countertrading include late or inferior quality counterdeliveries and lack of sales. Also, rapidly changing global and national economic conditions could force one of the parties to break its contractual obligations. It is not easy to predict the behavior of counterpart in a long-time countertrade accord. There will be uncertainties involved as the contractual time period lengthens. Managers of international firms should be aware of these problems, they must formulate contracts clearly aware of these problems and develop contingency plans to deal with problems as they arise. A special effort must be made to maintain communication between trading counterparts.
5. *Offer countertrade in order to market grand packages.* Some goods and projects, such as aircraft sales or building petrochemical complexes, are very expensive and they are more subject to countertrade deals than others. Multinational firms marketing such grand packages should be aware that Third World and Socialist countries will demand countertrade for such purchases. To make their proposals attractive, international firms can incorporate elements of counterpurchase, offset, or compensation in their offers.

Overall, developments in counterpurchase, offset, and compensation trading call for the attention of international business managers. The strategic process proposed in Figure 1 helps those managers to develop countertrade strategies.

Conclusions

Strategic responses of MNCs to environmental changes determine their level of success. During formulation and implementation of multinational strategies, managers are expected to scan global and national economic conditions, identify feasible alternatives, and make sound choices. Countertrade appears to be an effective strategic alternative. To use this particular option efficiently, international managers should learn the motives of parties involved, actively seek competitive advantages, form alliances when needed, re-equip or re-organize structures to cope with countertrade problems, and be able to market grand packages through countertrade.

Recent worldwide developments indicate the number of countertrade arrangements in the form of counterpurchase, offset, and compensation will continue to increase. Policymakers and international marketers should know when and why these transactions occur, and how to deal with them. Nevertheless, countertrade is a time-consuming process and requires a specialized knowledge and experience. To gain the necessary specialized knowledge and experience, business organizations must make strategic commitments to the concept of countertrade. The countertrade model and strategy development framework provided herein should be useful in understanding

this form of exchange and in constructing business strategies to exploit the possibilities arising from this emerging trend in world trade.

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