

Countertrade

CIPS has formulated viewpoints on countertrade as it is becoming increasingly prevalent due to today's greater ease of global sourcing.

CIPS would identify three key areas in particular where purchasing and supply management professionals can be of assistance to their organisations:

- assessing product value;
- developing the supply base; and
- exploiting reverse countertrade when appropriate.

CIPS
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WORKS

Knowledge
Summary

Introduction

CIPS believes that purchasing and supply management professionals should be familiar with countertrade, like other aspects of international trading, and should provide guidance to their organisations when faced with the prospect of countertrade. Reference should also be made to the CIPS Knowledge Summary document on Ethical Business Practices, in particular Reciprocal Trading, which is a form of countertrade. The relevant paragraph reads:

“Reciprocal Trading, which makes being a customer of an organisation, a condition of being a supplier is generally unacceptable business practice. It is acceptable only when:

- There is no coercion
- Both parties are in agreement
- There is mutual benefit and transparency.”

CIPS believes that countertrade arrangements can be professional and ethically acceptable provided that all parties involved enter into such arrangements freely and transparently, without any form of coercion and are to the mutual satisfaction of both parties.

CIPS Positions on Practice

CIPS views are stated throughout this document but the key statements are summarised below:

- CIPS believes that purchasing and supply management professionals should be familiar with the principles of countertrade and be able to provide guidance to their organisation when the occasion demands.
- CIPS takes the view that countertrade arrangements are only ever an acceptable aspect of a buyer/seller relationship when neither party has been coerced into entering into such a relationship.
- CIPS warns against underestimating the often very complex issues which can arise in counter trade-based relationships.
- CIPS believes that purchasing and supply management professionals should provide practical assistance to their organisations if and when they enter into countertrade situations.
- CIPS recommends that if an organisation is contemplating entering into a countertrade agreement, purchasing and supply management professionals should be involved in the discussions/negotiations at the earliest opportunity.

What is Countertrade?

Countertrade is an umbrella term covering a wide range of commercial mechanisms for reciprocal trade. It can manifest itself in several forms but always involves payment being made, at least partially, in goods or services instead of money. It often occurs when multi-national companies sell to a customer abroad and that customer pays by providing goods to the multi-national company. In some countries, countertrade is a condition of the buying organisation importing goods from elsewhere.

There are a number of key variations in countertrade including:

Barter - which is the simplest form of countertrade as no money changes hands and so the transaction is a straight exchange of goods.

Buyback - is usually associated with a turnkey type project in that it involves the provision of the means to deliver goods or a service in exchange for raw materials or some other product, usually to be supplied at a later date in the contractual arrangement. As the time scales can be quite lengthy there are obvious risks which need to be managed to ensure that the contract is concluded satisfactorily. An example is a construction company which builds a plant or factory and once it is on stream takes an agreed percentage of the output as payment.

Counter-purchase - the seller agrees to buy goods from the importer, the value of the goods is a percentage of the price of the goods exported, or the majority of the goods are paid for in cash.

Offset - is where a percentage of the goods countertraded are paid for in goods as opposed to money. A direct offset is one where the goods traded are associated with one another whereas indirect offset is for example accepting tomato paste in part payment for the sale of cabling.

Other examples include inter-company trading and reciprocal trading. All purchasing and supply management professionals should take care to observe the constraints of competition law and be wary of entering into anti-competitive agreements or abusing a dominant position in the marketplace.

There is also a phenomenon known as ‘**reverse countertrade**’, a practice whereby organisations advise foreign trading partners of their existing and future sourcing needs. Only after availability has been confirmed do they set about selling their own products abroad.

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Extent of Countertrade

Developing countries tend to have two reasons for using countertrade:

- in order to export e.g. they use their purchasing power to encourage foreign countries to take some of their exports.
- in order to import e.g. when they have problems financing imports through more traditional means.

Despite the difficulty of establishing the extent of countertrade a certain amount of statistical information is available. For instance one source states that over 140 countries are engaged in it. The truth is however that the extent of countertrade is difficult to establish with any accuracy. Some figures are mutually contradictory. It is not even clear whether countertrade is growing or decreasing in popularity.

One change on the world stage which clouded the issue was the collapse of the former Soviet empire. Under the Soviet regime the countries of Eastern Europe were compelled to countertrade with the USSR. A typical arrangement would have been for Czechoslovakia to use domestically-manufactured machine tools to pay for imports of Russian grain. Though this example is taken from the 1990's, similar trading systems exist today. The UK government's website (www.uktradeinvest.gov.uk) cites the example of Vietnam promoting countertrade, especially during slow financial periods, to help control the balance of trade. Countertrade is mainly conducted with Former Soviet Union and Eastern European nations - Vietnam's traditional trading partners. Local requirements dictate whether buyback, barter or counterpurchase is used for each contract. Countertrade is dependent on negotiations between the business entities involved in the contract. Procedures for import and export are simplified to facilitate countertrade, for instance no import licence is necessary for goods bought with commodities, except for products that already have import restrictions on them. Vietnamese products that can be used for countertrade include coal, marine and agricultural products and other commodities.

Issues of Countertrade

Some international organisations such as the World Trade Organisation (WTO) consider that countertrade constitutes a distortion of the free trade process; in particular, in countertrade situations the true value of transactions is difficult or impossible to establish. Furthermore, it is considered by some to be, for want of a better word, 'underhand'. Certainly, a few companies do steer clear of publicising the fact that they are engaged in it. Partly for this reason the true extent of countertrade is difficult to establish. Suffice to say, the potential of countertrade in helping an organisation realise its strategic objectives has not been fully explored.

CIPS does not intend to oversimplify the issue of countertrade. It can be a very complex commercial transaction. There is much anecdotal evidence that the goods received are often not as stated, or not quite as expected, and in some cases are completely different. Therefore, there is great risk of inferior foreign goods being unloaded onto the home market. There is also the likelihood of more protracted and complex negotiations and the uncertainty that this can generate, not to mention slow and unpredictable deliveries.

As most countertrade occurs when the selling organisation's

economy is not sufficiently strong to support the foreign currency demands which the purchasing and supply management professional would require, or government restrictions are in place, CIPS would encourage purchasing and supply management professionals to be cognisant of the political reasons why countertrade may be desirable.

Another issue with countertrade in the case of small firms for instance who often find it difficult to take on board the additional costs which are involved.

Nevertheless 'offset' is frequently seen in procurement of military equipment from foreign suppliers, particularly when there is a need (as is often the case) to avoid possible economic and political repercussions from not choosing a domestic supplier.

One benefit of countertrade is that it can sometimes provide access to production materials which might otherwise be unavailable; it can sometimes provide an efficient channel for the disposal of obsolescent goods which might otherwise be difficult to sell.

Purchasing and Supply Management Professionals and Countertrade

CIPS believes that purchasing and supply management professionals should assist their organisations in their sales involving countertrade by:

- negotiating the fee to the banks or other bodies facilitating the transaction.
- valuing, and evaluating, the goods and services offered by the buying organisation
- evaluating and minimising the risks involved with the countertrade transaction or contract
- ensuring that their own organisation can use the goods and services to be received and that they are an economical source compared to alternative sources.
- ensuring that if the organisation has no use for these goods or services, that they can be sold on at a cost which not only generates a profit but which also covers the administrative cost of the countertrade transaction, negotiating a more suitable offer of goods and services from the selling organisation if it transpires that those offered are not a viable option.
- challenging the perceptions of colleagues in sales and marketing.
- finding new potential customers for these products.
- working with suppliers post transaction if appropriate, for example, in supplier development projects.
- exploiting reverse countertrade as appropriate.

CIPS believes that purchasing and supply management professionals should be involved with countertrade agreements at the earliest opportunity and that this should be made a component of the organisation's international trading policy and procedures.

One forum for the exchange of countertrade information is the LCR (London Countertrade Roundtable). Based on the personal contact principle, this group meets from time to time to discuss matters of mutual interest. Further details are available at www.londoncountertrade.org.

Countertrade

Research Findings

Not surprisingly, research suggests that organisations with knowledge or experience of countertrade make more international purchases than those who do not. More generally, research has indicated that purchasing professionals are broadly sympathetic to the practice of countertrade, tending to consider that its benefits outweigh its disadvantages. Not surprisingly perhaps, the buyer's knowledge in choosing what products to counterpurchase is important, as is the ability to monitor quality delivery performance, etc. One interesting fact to emerge from one of the academic studies of countertrade is that top management only turn to traditional purchasing after it has been decided that a countertrade arrangement proposal is acceptable. Studies have also established that the role of purchasing acquires particular significance in those cases where the incoming products within a countertrade deal are for use in-house.

Conclusions

CIPS encourages purchasing and supply management professionals to investigate the extent to which their organisations are involved with countertrade arrangements and offer their services accordingly. Purchasing and supply management professionals should assist in broadly three ways:

- assessing product value, quality, delivery and disposal possibilities.
- developing the supply base through countertrade, in other words, by working with these suppliers post transaction.
- exploiting reverse countertrade when sourcing globally.

Countertrade is a minefield of complex commercial issues. Well trained purchasing and supply management professionals should be able to steer their organisations through these transactions whilst ensuring that relationships remain ethical and that potential advantages of countertrade are realised.