



Distribution Channels in Export Promotion: Can the State Help?

Summary

To successfully perform the Belarusian economy is highly dependent on the degree to which it is incorporated into world trade through export operations. However, Belarusian exports are concentrated in a limited number of destinations and goods, mostly related to the legacy from Soviet times. Therefore, the National Program of Export Promotion for 2006-2010 highlights the crucial needs both for export market diversification and for shifting the export specialization to knowledge-intensive and high-tech products as well as to new markets. This in turn raises the question of whether the state should provide assistance to promote exports, and, in particular, whether it should help to create distribution channels abroad.

This paper gives a brief overview of the techniques used by the Belarusian government to market exports, in particular the creation of distribution channels, as this part of the export activities of Belarusian enterprises is usually not very effective. On the other hand, the effectiveness of the government's participation in such issues is also quite debatable. International experience has shown that state involvement supporting the export marketing of companies is rather narrow and limited to market consultancy and analysis, performing the function of information transmitter, promotion of trade fairs abroad, project consultancy and support, establishing business contacts and organizing meetings and economic forums, mainly without any direct involvement in building distribution channels. Therefore we conclude that the most effective way of export promotion and marketing is general trade liberalization, privatization and transfer of export incentives and decisions to the micro level. This applies particularly to the design and creation of distribution channels.

Contents

1. Introduction	2
2. The present state of Belarusian exports	2
3. Survey results	3
4. The role of government in creating distribution channels: International experience	5
5. Conclusions	6

1. Introduction

Exports play a pivotal role in the Belarusian economy. Same as in any other small economy, the major reason is the tightness of the domestic market. Certain companies can only sell 5% of their output on the domestic market. Thus, for instance, the domestic sales of Belarusian tractors are only about 10%. In addition, Belarusian exports are concentrated in a limited number of markets and goods, which are usually a legacy from Soviet times. Therefore, the National Program for Export Promotion for 2006-2010 emphasizes the crucial need for diversifying the export market and shifting exports to knowledge-intensive and high-tech products. It also affirms that one of the crucial factors for successful exporting is the creation of efficient distribution channels.

Distribution channels are defined as the methods of getting the product or service to the customer. In other words they are intermediaries between the manufacturer and the retailer or the business customer in the case of commercial or industrial products (e.g. sales agents, manufacturer's representatives, selling agencies, wholesalers, trading houses). Traditionally the creation of distribution channels rests within the competency of the enterprise itself.

To promote Belarusian exports the present main emphasis is to create "direct" distribution channel establishments abroad (such as representation offices, trading houses, service centers, consignment warehouses, etc.), which are either fully or partially owned by Belarusian economic agents. However, most Belarusian exporters do not possess sufficient expertise, qualified personnel, or financial resources to promote their products abroad, including export promotion through the creation of distribution channels. In cases where the enterprises' resources and opportunities are limited, the state may believe it necessary to step in to cover this gap.

On the basis of international experience we consider in this paper whether and to what extent the state should provide support in creating distribution channels. We first examine the main characteristics of Belarusian exports. We also focus on the results of a recent survey of exporters. Then we describe the international experience, of other states creating distribution channels abroad. Finally we sum up the discussion and conclude.

2. The present state of Belarusian exports

Exports play an important role in the Belarusian economy. The share of export in GDP amounted to 54.2% in 2005. However, as Table 1 shows, Belarus has been changing its historical regional patterns of trade very slowly. Prior to 2005 Belarus' trade flows were directed towards the CIS market (mainly to Russia) more than to the rest of the world, and to the EU in particular. Table 1 clearly indicates Russia's importance as the main export destination. Thus, Russia received 45.6% of total exports in 1995 and 47.1% in 2004. Yet, the introduction of the new VAT taxation mechanism with Russia¹ led to a deterioration of the trade flows to Russia, shifting some exports to markets in the rest of the world (the share of Russian exports declined to 35.8%, and the share of non-CIS destinations increased to 55.8% in 2005). It should be noted that the adjustment was not the result of improved competitiveness of Belarusian products in markets in the rest of the world (ROW) but rather a consequence of inadequately designed principles of VAT return with Russia.

¹ See GET PP/06/05 "Value Added Taxation within the Customs Union of Belarus and Russia: Concept, practices, and lessons".

Table 1: Structure of Belarusian exports by destination (% of total)

	2002	2003	2004	2005
CIS	54.7	54.7	53.1	44.2
of which Russia	49.6	49.2	47.1	35.8
Rest of the World (ROW)	45.3	45.3	46.9	55.8

Source: Ministry of Statistics and Analysis.

In addition to the above considerations, the limited range of Belarusian export products restrains any potential expansion of non-CIS trade flows. Table 2 shows the structure of exports by groups of goods. The product composition of Belarusian exports to the rest of the world did not experience any substantial changes, remaining concentrated on mineral products, non-precious metals and chemical products. In fact, the share of mineral products increased steadily, accounting for 52.1% in 2005. Belarusian exports to CIS countries were increasingly dominated by mineral and chemical products, non-precious metals, agricultural products and foodstuffs as well as textiles. Thus, exports of these groups of products represented 45.1% in 2002 and 47.5% in 2005, whereas the share of exports of machinery and transport equipment, instruments and apparatus into the CIS remained nearly steady between 2002 and 2005 (ranging from 37.3% in 2002 to 37.7% in 2005). These facts indicate that Belarus did not manage to change its export profile. There was no shift in the structure of exports towards an increased share of competitive energy-saving, high-tech products, primarily due to tight government controls over foreign trade activities: instructions to maximize exports and reduce imports to meet official targets, as well as lack of privatization, foreign direct investments, modern technologies, and advanced management techniques.

Table 2: Structure of Belarusian exports by groups of goods (% of total)

	Mineral products	Machines and equipment	Transport	Chemical products	Textiles	Agricultural products and foodstuff	Non-precious metals
Total							
2002	20.9	11.9	12.2	17.7	6.1	7.9	8.2
2003	22.6	11.7	11.3	16.9	5.7	8.6	8.6
2004	22.7	13.4	11.3	16.9	5.8	8.4	8.7
2005	27.5	12.0	11.3	15.3	4.9	8.5	8.8
CIS							
2002	3.0	19.1	18.2	15.3	6.3	12.7	7.8
2003	2.5	19.2	17.2	14.5	6.1	14.0	9.4
2004	2.4	20.6	17.3	14.5	6.2	13.7	9.4
2005	5.7	19.6	18.1	12.0	5.8	14.6	9.4
ROW							
2002	42.6	3.1	4.9	20.6	6.5	2.2	8.9
2003	47.0	2.5	4.0	19.8	5.3	1.9	9.5
2004	47.1	4.8	4.0	19.8	5.3	1.9	7.7
2005	52.1	3.4	3.7	19.0	4.0	1.6	8.1

Source: Ministry of Statistics and Analysis.

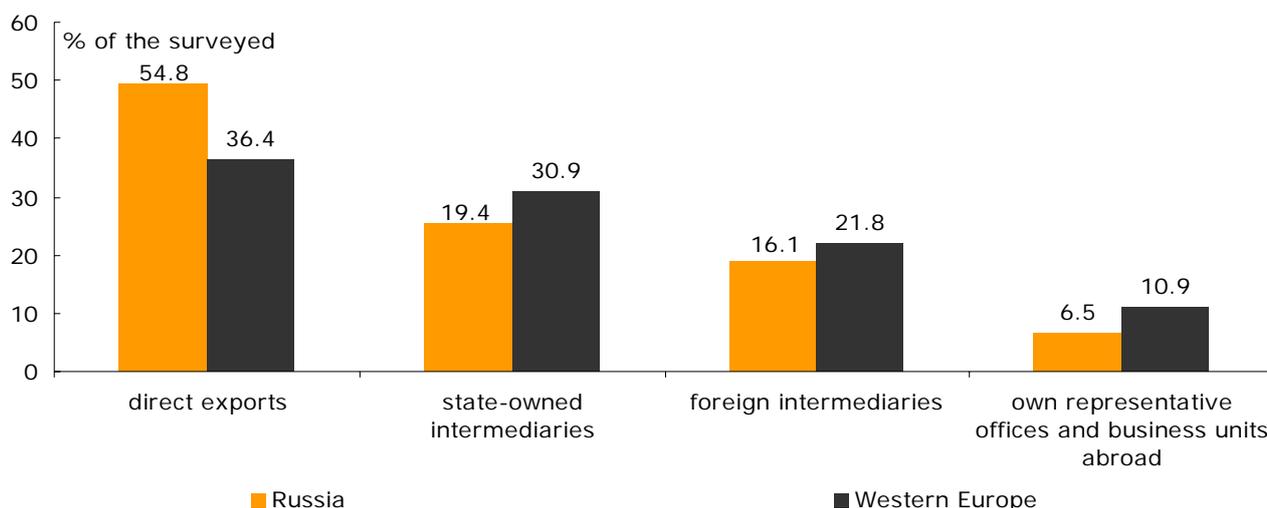
3. Survey results

The data collected during the recent survey of industrial exporters (conducted by the Institute for Privatization and Management (IPM) in August-September 2005) clearly demonstrate the belief that distribution channels play an important role in successful exports. Asked to rank the major impediments to increasing exports, the interviewees listed the absence of distribution channels first (26.5%), followed by complicated customs procedures (21.4%), and only then noted the uncompetitive price of their products (21.0%). All other factors were assessed as being less important.

Belarusian exports concentrate mainly on two regions – Russia and Western Europe. As mentioned above, the main Belarusian export partner is Russia. Exports to Russia have a long tradition. The legacy of the Soviet Union has left an extended network of export partners in Russia, coupled with similar market characteristics and customer

demands. As the result, exports to Russia are much more common than to Western Europe, where established ties with customers are less widespread. Notably, 50% of those exporters that concentrate on West European markets use the services of Belarusian state-owned intermediaries or foreign intermediaries, while only 35.5% of exporters concentrating on Russian markets use such services. Only 6.5% of those companies that export mainly to Russia maintain their own representative offices or business units there. The number of those who have their own representative offices or business units in Western Europe is somewhat larger – 10%.

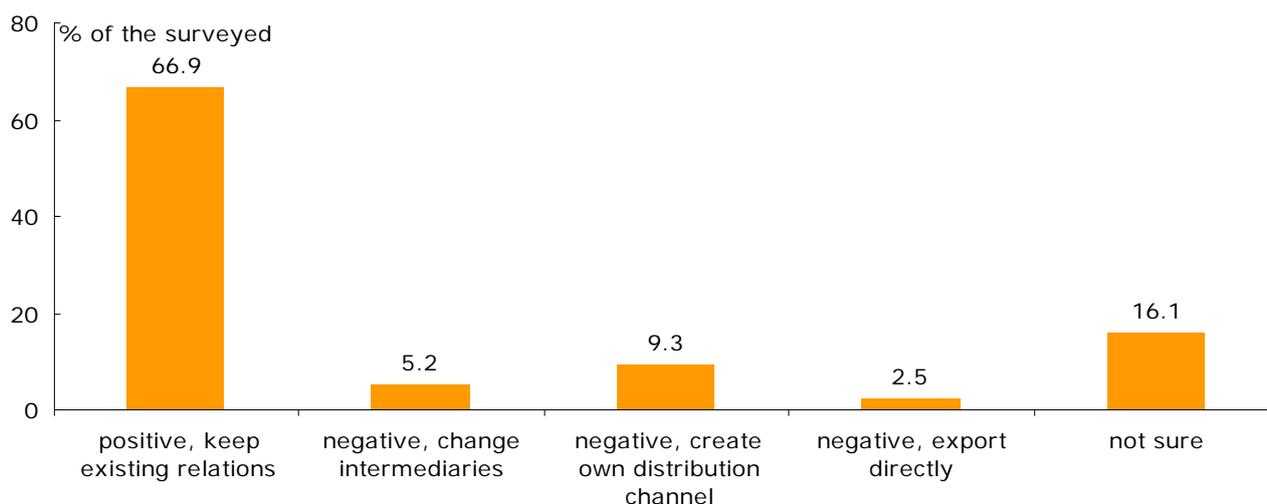
Figure 1: Modes of exports (destinations Russia and Western Europe)



Source: IPM industrial exporter survey, August-September 2005.

Another peculiarity of Belarusian exports is that the majority of exporters are state-owned enterprises, or enterprises with significant state participation. As a result, state-owned intermediaries are very popular among Belarusian exporters, and there are no private Belarusian intermediaries that support Belarusian exporters.

Figure 2: Assessment of the present relations with intermediaries and action plans



Source: IPM industrial exporter survey, August-September 2005.

The majority (66.9%) of the surveyed exporters that use the services of intermediaries assess the cooperation positively and plan to continue using the existing services. A smaller number of the surveyed exporters intend to change intermediaries (5.2%) or create their own distribution channels (9.3%). Only 2.5% of those who currently use the services of intermediaries want to export directly. This data supports the fact

that Belarusian exporters appreciate the role of intermediaries for optimizing their export schemes.

The National Program of Export Promotion for 2006-2010 emphasizes the importance of export market diversification. In this context, to stimulate the creation of distribution channels by using intermediaries could facilitate export growth.

4. The role of government in creating distribution channels: International experience

Measures to promote national exports vary widely throughout the world, depending on the level of each country's economic development, traditions, and industrial development priorities. In most developed nations the creation of distribution channel is initiated by the enterprises. At the same time the state can implement national export strategies to support exporters when creating distribution channels. In some less developed countries, such as India, on the other hand, the initiative to promote distribution channels rests with the state.

Throughout the world there exist specialized trading companies that perform a limited number of functions, as well as some that perform a broad range of functions. Small and medium-sized trading companies usually specialize in exports of technology intensive or specialized products; large ones – on exports of raw materials or agricultural products.

USA

In the USA there exist export management companies and export trading companies. The main purpose of export management companies is to perform the export activities of one or several enterprises. They serve as an external export department for the company. These companies primarily work with small and medium-sized enterprises with the aim to aggregate their competencies in exports and overcome constraints in resources while entering foreign markets. In contrast to export management companies, export trading companies are guided by the demand on external markets, they study these markets and then search for national producers to export the necessary products.

Both small narrowly specialized intermediaries, and large international distributors of finished products and raw materials are available in the USA. Intermediaries in the USA are primarily intrasectoral, they specialize in the exports of products belonging to the same industry branch.

A special act, concerning export trading companies was adopted in 1982, which allows banks to participate in the creation, financing and development of trading houses. It also protects trading houses from antitrust proceedings. This act did not, however, have the desired effect: banks could not be induced to play an active role in the creation of distribution channels, and the impact of the export facilitation was not as positive as had been expected.

EU

There exist many small trading houses in Germany (e.g. about 3000 in Hamburg). As the experience has shown, the competitive advantage of these trading houses is based more on their specialized knowledge than on their financial capabilities. German trading houses deal primarily with finished products.

Japan

Trading houses in Japan were primarily assigned quasi-monopolies in foreign trade, they enjoy tax and cost benefits and the permission to create large-scale conglomerates, that are forbidden in other countries. The state basically forced native enter-

prises to export and import through trading houses. Japanese trading houses specialize not only in exports, but also imports.

The turnovers of Japanese trading companies exceed European ones a hundredfold. In recent years ten large Japanese trading houses (sogo shohas) controlled over half of Japanese exports. As a rule, the large Japanese trading houses, as well as some small ones do not export finished goods. Their competencies lie in the sphere of standardized food stocks and raw materials.

Japanese trading houses have been developing in parallel with the Japanese economy. As the result, they are well integrated into its structure, are multifunctional and have established ties throughout the world. Still, successful producers such as Toyota, Honda or Matsushita do not use the services of centralized trading houses. They conduct international marketing independently.

China

Based on the example of conglomerates and trading houses in Japan and South Korea, multifunctional corporation-giants are being created in China. Among other functions they also perform export operations. The aim of such organizations is to withstand external competition.

A characteristic of China is that the privatization of enterprises is limited; despite the fact that some private enterprises develop here most dynamically. As the result, the control over the economy and foreign trade operations remains in the state's hands.

Brazil

The number of Brazilian trading companies is much smaller than in Europe or the USA. Trading houses in Brazil were developed as the result of active state support. Again, the model was adopted from Japan. But the Japanese model did not work as well as expected in Brazil. Large state-owned companies or companies with significant state ownership are highly bureaucratized here. This causes them to react slowly to changes in external markets. Moreover, the main aim of trading house development in Brazil was to facilitate the export of finished products produced by small and medium-sized enterprises; however, they never fully achieved it.

5. Conclusions

As international practice has shown:

- Direct state involvement in the creation of distribution channels did not always lead to the expected positive results;
- Merely concentrating on setting up trading houses or representative offices does not automatically lead to export success; there remains a need for strategic activities of enterprises to improve their products, to develop exports, and to create efficient distribution channels abroad;
- State support to promote exports, in particular building distribution networks in developed and less developed countries is primarily targeted at small and medium-sized enterprises, since they usually lack the technical and financial resources, and the specialized expertise for performing export operations.

Significant for the Belarusian export distribution strategy is that the government is so broadly involved in the exporters' businesses, since state-owned enterprises dominate in all export sectors. As a result, export-marketing issues are determined at the state level.

But international experience has shown that:

- State involvement in support of export marketing is rather narrow and limited to market consultancy and analysis, performing the function of information transmitter, promotion of trade fairs abroad, project consultancy and support, establishing business contacts and organizing meetings and economic forums;
- Diplomatic representations of the country abroad can play a vital role in serving as a counseling intermediary in export issues;
- The most effective way of export promotion and marketing is general trade liberalization, privatization and transfer of export incentives and decisions to the micro level;
- Trading houses and other objects of distribution network are broadly organized within the territory of the exporter, as legislation in some countries does not allow foreign participation in their importing and distribution sectors.

Thus, the government should assist exporters in performing their foreign activities by creating a favorable external environment and incentives for exports. It can also promote exports by technical and financial support (mainly indirect). Also, the focus should be on SMEs that lack the resources for such activities. Still the primary decisions in export issues, including the modes of distribution should initiate from the companies themselves. Such decisions should be taken at the micro level to take into account all the peculiarities of the company, its products and the targeted markets.

Authors: Irina Tochitskaya, Anastasia Glambotskaya

Lector: Ricardo Guicci

Minsk, March 2006