


P&SM: Countertrade



A commercial transaction, in one or a series of related contracts, for payments by deliveries of goods and/or services in addition to, or in place of financial settlement



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Introduction

The CIPS' practice documents are written as a statement in time. They are a collection of views on good practice within a particular subject area and are intended to provide direction on good practice with some guidance for context and interest. The reader is encouraged to use the CIPS practice documents for their own purposes, such as writing policy statements, guidance or procedures. This particular practice statement has been written primarily for the benefit of full-time purchasing and supply management professionals, but can be used by anyone associated with, or interested in, purchasing and supply management (P&SM).

This document is about trading between organisations when the settlement is not wholly in cash and what role the P&SM function should play in these transactions.

Definition

Terms vary from country to country and (even within the same country) by author. The following document takes this into account.

The CIPS definition of countertrade is “a commercial transaction, in one or a series of related contracts, for payments by deliveries of goods and/or services in addition to, or in place of financial settlement.” It goes beyond normal trade in that buyers and sellers accept reciprocal deliveries in part or full settlement of the value of their deliveries.

Background

Developing countries tend to have two reasons for using countertrade:

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

Some international organisations such as the WTO (World Trade Organisation) 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 underhand. In response to this, 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.

As most countertrade occurs when the buying organisation's economy is not sufficiently strong to support the foreign currency demands which the P&SM professional would require or government restrictions are in place. P&SM professionals should be cognisant of the political reasons why countertrade may be desirable.

Another issue with 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.

Explanation

Main Types of Transaction Covered by the term Countertrade

- 1) Barter – the direct exchange of goods simultaneously with no intervention of 3rd parties.
- 2) Countertrade with Full Compensation – parties accept that the full value of goods supplied will be offset by a reverse flow of goods (counter deliveries) of equal value. A delay may occur between the delivery and counter delivery. 3rd parties may assume obligations.
- 3) Counter-Purchase (or Parallel Transaction) – two contracts made: one for the delivery of goods and the second for the repurchase of goods. They are separate and independent.
- 4) Counter-Purchase with Partial Compensation – when the reverse flow of goods may be supplemented with cash or through appropriate credit arrangements.
- 5) Product Buy-back – where the exporter (often of capital equipment) agrees to repurchase of goods produced from his equipment or as a result of turnkey contract. Buyback is usually associated with a turnkey type project in that it involves the provision of the means to deliver a good or 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.

- 6) Offset Agreements – ‘offset’ is a commercial mechanism employed by Governments to provide benefits and other enhancements to the overall cost of defence procurements and related contracts. From a customer perspective, the broad purpose of this is to reduce foreign currency outgoing, compensate domestic industry and develop the indigenous industry base employment and training.

The types of offset typically prescribed or requested by the customer could be driven by economic, industrial and sociological factors. The utilisation of offset has now become a far more widely used and complicated mechanism as its value has been understood and the potential benefits have matured into a far more wide ranging breadth of work packages, so much so that it is now possible to agree Offset Credits with governments in advance of the placement of future contracts¹. Offset related projects can be loosely categorised into either of the following:

- (a) Direct offset – offset activities directly related to the platform/product or service supply base including license manufacturing. Through careful supply chain management, direct offset can be delivered via strategically placed aerospace and defence work packages and related subcontract work within the customer country.
- (b) Indirect offset – offset activities derived outside the platform/product/service supply base including aerospace, defence, unrelated activities, investments and countertrade agreements. Indirect offset, as the title suggests, is a much broader concept and is typically delivered via the following list (although this list is not exhaustive):

¹ Stevens, John: Global Purchasing and the Rise and Rise of Countertrade, Purchasing and Supply Management, September 1995.

- Technology transfers
- Marketing assistance
- Investments
- Socio-economic programmes
- Education and training
- Joint ventures

7) Intra- or Inter-Company Trading – this has been employed to support a group member which may be struggling to cover fixed costs when introducing a new product, and can be international or take place within one country. This is sometimes reflected in transfer pricing depending on which party is to be supported; the supplier might transfer material at cost only to support a customer, or the supplier might be supported by paying full cost and a margin. ‘Arms-length’ intra-trading suggests member companies are treated as if outside suppliers.

8) Reciprocal Trading (or Reciprocity) – this was the blanket term for most of the transactions listed. The pioneering reference was an article by Dean S. Ammer². It makes being a customer of an organisation a condition of being a supplier, and is generally unacceptable business practice.

9) 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.

10) Switch Trading – this involves trading between three or more countries to overcome the problem of imbalances of money flows between the countries involved.

Viewpoints and Guidelines on Conducting Countertrade Agreements for P&SM Personnel

CIPS believes that P&SM professionals should be familiar with countertrade, like other aspects of international trading, and should provide guidance to their organisations when the occasion demands.

CIPS would identify three key areas in particular P&SM management professionals can be of assistance to their organisations:

- 1) Assessing product value
- 2) Developing the supply base
- 3) Exploiting reverse countertrade when appropriate

CIPS recommends that, if an organisation is contemplating entering into a countertrade agreement, P&SM professionals should be involved in the discussions/negotiations at the earliest opportunity.

P&SM professionals should particularly assist their organisations in their sales involving countertrade by:

- Negotiating the fee to the banks or other bodies facilitating the transaction

² Ammer, Dean S: Realistic Reciprocity, Harvard Business Review, Jan/Feb 1962

- 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 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 to the mutual satisfaction of both parties.

It is not CIPS intention 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 goods being unloaded onto the 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.

Conclusion

CIPS encourages P&SM professionals to investigate the extent to which their organisations are involved with countertrade arrangements and offer their services accordingly.

Countertrade³ is a minefield of complex commercial issues. Well trained P&SM professionals should be able to steer their organisations through these transactions whilst ensuring that relationships remain ethical and that potential advantages of countertrade are not lost because a one-sided approach has locked the organisation into the deal.

³ <http://www.globaloffset.org/>

CIPS Group Easton House, Easton on the Hill, Stamford, Lincolnshire, PE9 3NZ, United Kingdom
T +44 (0)1780 756777 F +44 (0)1780 751610 E info@cips.org

CIPS Africa Ground Floor, Building B, 48 Sovereign Drive, Route 21 Corporate Park, Irene X30, Centurion, Pretoria, South Africa
T +27 (0)12 345 6177 F +27 (0)12 345 3309 E infosa@cips.org.za

CIPS Australasia Level 8, 520 Collins Street, Melbourne, Victoria 3000, Australia
T 1300 765 142/+61 (0)3 9629 6000 F 1300 765 143/+61 (0)3 9620 5488 E info@cipsa.com.au

CIPS Middle East & North Africa Office 1703, The Fairmont Hotel, Sheikh Zayed Road, PO Box 49042, Dubai, United Arab Emirates
T +971 (0)4 327 7348 F +971 (0)4 332 5541 E mena.enquiries@cips.org



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