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„Countertrade as Internationalization Strategy.“

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Abstract

The aim of this study is to examine the role of countertrade in the internationalization process, to figure out which factors influence the decision of using the Countertrade. Specifically, this thesis researches the motives of developing and developed countries, political motives, reasons of the buyer and seller. Moreover, it will be determined why countertrade is growing, its problems and risks. Furthermore, this thesis examines two theoretical concept, concerning the countertrade, namely Transaction Cost Theory and Network Theory.

This research considers all types of countertrade and their place in international trade.

The following study is based on the already existing empirical and theoretical studies.

Method of writing that has been used was the studying the literature regarding the countertrade.

Well known data bases have been used to identify journals and papers about CT in the period from 1983 to 2014.

Key Words: *Countertrade, internationalization, mandated countertrade, network theory, transaction cost theory, barter, counter purchase, buy-back, switch trading, and outsourcing.*

Glossary

CT	Countertrade
GATT	General Agreement on Tariffs and Trade
IMF	International Monetary Fund
FDI	Foreign Direct Investment
MNE	Multinational Enterprise
TCT	Transaction Cost Theory

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1. Introduction

Countertrade is the most fascinating and the most important topic of the international business in the history of mankind (Lecraw, 1989). It is a common expression for transactions in the „international trading environment“ and covers all forms of two-way trade agreements (Papadopoulos, 1993).

In general, Countertrade is a form of two-way trade, which is practiced in most cases internationally by developed and developing countries, by large and small companies and also by governments from around the world (Caves and Marin, 1992; Esteban de la Rosa, 2011). Countertrade is a trade arrangement, where “seller provides a buyer with products and agrees to a reciprocal purchasing obligation with that buyer” (Paun, 1997, pp 41).

The main characteristic of countertrade is "need" or “necessity”. The main motivating element for one side or another is the need to buy or sell goods (Oh, 1985).

This study is aimed at presenting an extensive overview of the countertrade, to give a detailed description and to reveal the reason behind this type of international trade. It will be determined who is often resort to the use of CT. What advantages partners expect from this type of transaction.

Because countertrade has a very long history of its existence, it will be necessary to highlight how this kind of trade has changed over the centuries (White, Miles and Randall, 1990; Al-Suwaidi, 1993; Esteban de la Rosa, 2011; Papadopoulos, 1993; Amann and Marin, 1994; Fletcher, 1998; Yavas, Freed, Vardiabasis, 2000).

There are two types of countertrade: mandated by government and voluntary countertrade. It will be described what it means to be “mandated by government”, what means for government to be involved in an international activity of this kind, what objectives the government is pursuing using CT; and what the government wants to restrict, prohibit or improve (Ellingsen and Stole, 1996; Lecraw, 1989; Fletcher, 2009).

Countertrade has many forms which are very different from each other.

- Barter Trade
- Counter purchase
- Buy-Back
- Offset
- Switch Trading

- Tolling

They all have different goals, methods and functions. In the third part of this thesis all types of countertrade will be described and examples will be given (Hennart, 1990; Paun, 1997; Khan, 2002; Lecraw, 1989; Palich, Ireland, Bagby, 2001; Ravas, 2011; Chao, 1980; Sumer, Chuah, 2007; Hennart, 1990; Papadopoulos, 1993; Camino and Cardone, 1997; Al- Suwaidi, 1993; Oh, 1985; Howse, 2010; Hervey, 1989; White, Miles, Randall, 1990; Mirus and Yeung, 1987; Balu and Norfadilah, 2002; Marshall and Wynne, 1996). It will be also defined the most common type of CT (Hennart and Anderson, 1993; Marin and Schnitzer, 1995; Chao, 1980; Sumer and Chuah, 2007; Balu and Norfadilah, 2002; Fletcher, 1998; Hennart, 1990).

Due to the fact that countertrade is very complex and multifaceted kind of international trade, there are many approaches regarding this topic. It will be very important to identify and describe two theories directly related to the countertrade, namely Network Theory and Transaction Costs Theory, which will help to understand the point of countertrade (Fletcher, 1998; Hosseimi and Dafbar, 2012; Amann and Marin, 1994; Hennart, 1989; Marin and Schnitzer, 1995; Hennart and Anderson, 1993; Papadopoulos, 1993; Egan and Shipley, 1996).

The most significant part of the following study is to determine what motivates the parties to use countertrade, as to the use of countertrade resort completely different partners.

Countertrade can be used by developed and developing countries, by private firms or governments. And each of them pursues their own goals. It will be considered which countries or firms tend to resort to the use of countertrade and what they want to achieve, with help of CT (Hennart and Anderson, 1993; Fletcher, 1998; Aggarwal, 1989; Oh, 1985; Papadopoulos, 1993; Esteban de la Rosa, 2011; Robert, 1989; Kham, 2002; Egan and Shipley, 1996; Nassimbeni, Sartor and Orzes, 2014; Paun, 1997; Hennart, 1990; UNICTRAL, 1993; Al-Suwaidi, 1993).

Then it will be described how and with what kind of methods the countertrade transactions are usually financed. Also highlighted will be the legal aspects of using barter, counter purchase and buy back arrangement (Khan, 2002; International Trade Finance, 2007; Financing U.S. Grains, 2004; Paun, 1997; Lecraw, 1989). As every transaction includes clauses, the more international a countertrade is, and the more clauses it has. For example, it may involve clauses concerning transfer to a third party, a linkage clause, and a penalty clause (Esteban de la Rosa, 2011).

Owing to the fact that countertrade is practiced at the international level, and includes a huge variety of goods and services, transactions of this type are characterized by the incredible complexity. This in turn leads to difficulties and problems, in particular to problems associated with the product or its quality (Park, 1983; Yearbook of the United Nations Commission on International Trade, 1988; Papadopoulos, 1993; Aggarwal, 1989).

Another important issue that arises when using countertrade is negotiation problem (Esteban de la Rosa, 2011, Aggarwal, 1989). As in any agreement there are weak and strong points. It will be described how they agree with each other as well as how they pursue their own goals.

Despite a number of advantages, countertrade also includes disadvantages and risks. Due to the fact that countertrade is a long-term agreement, it is logical to conclude that risks in this kind of arrangements take place. It will be discussed whether developed or developing countries face great risks (Yavas, Freed and Vardiabasis, 2000; Wilson and Wang, 1996; Khan, 2002; Al-Suwaidi, 1993; Papadopoulos, 1993; Hennart and Anderson, 1993; Robert, 1989).

Scientific journals in recent years have given the topic of countertrade a less illuminated presence making some think it is losing its popularity. Opinions of various experts will be considered in examining countries which actively as well as those that do not actively use countertrade.

According to Fletcher (2009) linked internationalization form includes not only the countertrade, but also the outsourcing. This study highlights the main features of the outsourcing and its characteristics in common with countertrade (Fletcher, 2009; Glass and Saggi, 1997; Egger H and Egger P, 2006).

2. Countertrade defined

Despite the widespread use of countertrade is difficult to find a suitable definition of this type of trade.

Countertrade is a general term that covers all trade relations which are tied to reciprocity (Vargo, 2012; Steele, 1998) “it is a global phenomenon, which involves interaction between parties from different countries” (Fletcher, 1998, pp 511; Vargo, 2012). It is a commercial agreement, where the seller selling the goods and services and receive in return other goods or services at all costs (Fletcher, 2009; Vargo, 2012).

In the first place countertrade is characterized by its complexity, because of high costs and the amount of participated individuals, by long-time negotiation, by the government involvement and by the mutuality (Fletcher, 2007; Stole, 1995).

Countertrade makes it possible for companies to gain some additional benefits, which cannot be received through normal purchase of goods or service (Paun and Shoham, 1996; Nassimbeni, Sartor and Orzes, 2014). This type of trade plays a significant role in the international business, where export and import transaction are directly connected.

“Countertrade can be viewed as a hybrid of joint venture, franchising, vertical integration, and foreign direct investment, under political and economic ownership constraints. Hence, countertrade is an integral part of international business well founded in modern micro-economic theory” (Wilson and Wang, 1996, pp36).

Usually, countertrade agreements involve two partners who cooperate with each other. Such partners can be private small or bigger firms and also governments (Khan, 2002; Caves and Marin, 1991).

The size of transactions is amount to hundreds of millions of US dollars (Fletcher, 1998).

The most important factors in transactions of this kind are the size, what kind of goods, which countries are participating in the transaction and which forms of countertrade are used (Fletcher, 1998). But countertrade is not only about the exchange of goods between the parties, there are also many additional obligations that both sides take and huge economic benefits for both sides. Countertrade is about “co-operation” (Esteban de la Rosa, 2011, pp 273).

In some types of this kind of trade it is difficult to say who the seller and the buyer is, because both buy goods and sell them to one another (White, Miles and Randall, 1990).

According to Ellingsen and Stole (1995) “two way goods flow made more than 10% of the world trade. In 1997, CT was about 25% of the world trade (Paun, 1997).

Globally, the most counteracted are the basic manufactures and industrial facilities (Fletcher, 2007).

According to Hennart (1990), Caves and Marin (1992), Hennart and Abderson (1993), countertrade takes place when there is a deficient competition or asymmetric information. There must be reasonable economic motivation for both sides of the CT, otherwise CT can be replaced by “money-mediated” transactions.

Countertrade today differs considerably from the countertrade which has been used in ancient times, when goods were just exchanged for other goods without the money involvement. Modern countertrade includes cash flows and concept such as “price and payment” (Esteban de la Rosa, 2011, pp 273).

There are three different kinds of use of CT:

- agreement between the private actors of the market;
- when the government itself directly involved in the purchase and sale of goods or services, pursuing their goals;
- when political interests are hidden behind a private actors, using the rules which restrict the use of CT.

There are several main characteristics of CT activity must be selected:

- CT is often used as an export encouraging strategy (Howse, 2010).
- In the first place exchanged in CT arrangements will be technical goods and investment, than plant and equipment (Marin, 1990).
- CT helps the international business to grow (Mirus and Yeung, 1986).
- CT can take place between private firms or be mandated by government to manage their problems with foreign currency. (Howse, 2010; Fletcher, 2009)
- CT can be long or short-term. Normally, Barter and Switch Trading are short-term arrangements. Buy-Back, Counter Purchase and Offsets are long-term agreements (Fletcher, 2009).

- CT is a “double coincidence of wants” (Mirus and Yeung, 1986, pp 29).

According to Egan and Shipley (1996) there have been distinguished four different approaches of the firm to the countertrade:

- First one is *defensive*, where for many reasons potential partners rather avoid using the CT.
- Second one is *passive* approach, where the use of CT is resorted to only in extreme necessity, and it happens very rarely.
- Third approach is *reactive*” when due to some circumstances or some powerful motivators partners use CT.
- And a forth approach is *proactive*, which means CT will be used very often. (Egan and Shipley, 1996) (Figure 1)

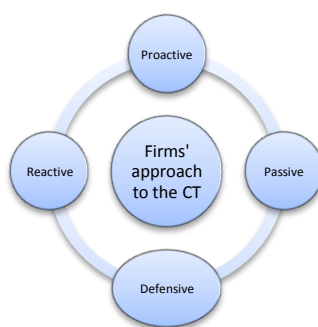


Figure 1. Firms' approach to the countertrade.

Source: Egan and Shipley, 1996

Also three categories have been defined, relating corporate attitude toward the countertrade:

- First one is *reluctant*, when the company completely abandons the use of CT, due to risks related to the use of this type of trade.
- Next one is *reactor*, uses CT in case of necessity coming from customer or in case of hopelessness associated with growing competition. Such companies learn how can CT arrangements be financed, and explore their chances.
- The third category is *initiators*, who already practice the CT to increase the competitive advantage, enhance the growth of the company and increase profits. (Egan and Shipley, 1996) (Figure 2.)

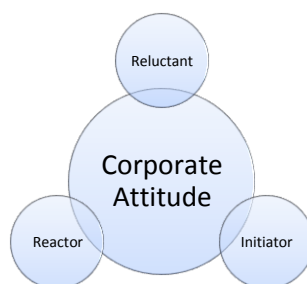


Figure 2. Corporate attitude toward the countertrade.

Source: Egan and Shipley, 1996

Interesting fact is that countries that are very often resorted to CT expose themselves to a variety of political and economic risks. And firms that actively participate in CT often sell products of low value (Egan and Shipley, 1996).

Some consider CT as “hybrid of Joint Venture” (Wilson and Wang, 1996, pp 36).

There are two types of countertrade:

- commercial CT, includes Barter and Counter purchase arrangements;
- industrial CT, includes Buy-back and Offset arrangements.

Countries, which actively using countertrade are: Finland, Greece, Italy, Norway, Turkey, South Africa, Sweden, and USA. In these countries about 13000 involved people.

Most countertraded products are raw materials, fuel and new technologies (Hennart, 1990). Oil and gas are included in the nearly eighty percent in barter transactions and only ten percent of counter purchase agreements.

Table1. Industries, which have a high potential for using a CT.

Service	Retailing	Manufacturing	Transportation
---------	-----------	---------------	----------------

Hospitals	Retailers	Cutting and forming	Truck lines
Nursing homes		metal shops	Railroads
Hotels		Molding and robber	Container shipping
Car rentals		plastic shops	lines
College			Bus lines
Universities			Airlines
Equipment			Package delivery
maintenance			service
Medical diagnostic			
lab			
Repair shops			
Engineering			
laboratories			
Testing labs			
Photo labs			
Warehouse			
operations			
Publishing and			
printing houses			
Proprietary schools			
Mass advertizing			
media			
Computer service			

Source: Barsankas P., Navickas V., and Sarapovas T. (1999) pp 50

Finally, there is a need to allocate perhaps the most important characteristic of this type of trade, and it is the versatility. Countertrade takes a lot of forms, which take place in different conditions at different scales and in different circumstances. Figure1 shows the forms of countertrade and its conditions.

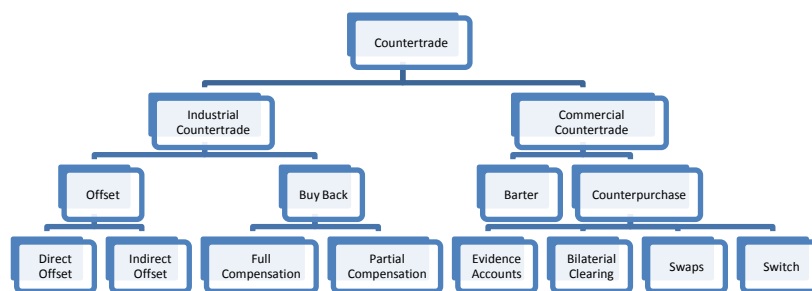


Figure 3. Countertrade Transactions.

Source: Fletcher R. (2009) pp 27

2.1 History of Countertrade

Countertrade has a long history leading back to early times, where goods were exchanged for goods without any money involvement (Esteban de la Rosa, 2011). Countertrade is the well known phenomenon and is an effective way of exchange of goods, which has been already used by mankind since ancient times (White, Miles and Randall, 1990).

Most of the existing countries have interchanged goods or services internationally. From the sixteen to the eighteen century almost all countries of Western Europe, in particular Spain, have widely practiced the countertrade (Al-Suwaidi, 1993). In eighteenth century with the introduction of the monetary system of payment, the use of countertrade declined. But later, during and after the First and Second World War, in the years of economic hardship countertrade had a lot of popularity, since the exchange of goods had life important mission (Al-Suwaidi, 1993).

Countertrade today differs considerably from the countertrade which has been used in ancient times, when goods were just exchanged for other goods without the money involvement. Modern countertrade includes cash flows and concept such as “price and payment” (Esteban de la Rosa, 2011, pp 273).

In the postwar period some international organizations have been created, such as GATT and IMF, which supported international trade including Countertrade (Papadopoulos, 1993). The main reason for increased use of Countertrade after Second World War was the ability to trade with “centrally planned economies” (Fletcher, 1998, pp 3). In the seventies and eighties there were global problems with the hard currency, which is why some countries have tried to establish commercial relations with help of countertrade, and countertrade was the only one

possibility to do it. (Esteban de la Rosa, 2011) Since the late seventies, CT enjoyed great demand among developing countries. (Amann and Marin, 1994)

In the last years of the eighties and early nineties were characterized by major changes in the economy, in politics and in terms of national borders in Europe (Fletcher, 1998). According to Ellingsen and Stole (1995) “two way goods flow made more than 10% of the world trade. In 1997, CT was about 25% of the world trade. (Paun, 1997)

In 2008, the percentage of CT use was about 30 percent.

2.2 Mandated Countertrade

There are two kinds of CT existing: voluntary CT and mandated by government.

When it comes to the essential question, why the firm chooses this type of trade as a way to enter the market, then when it's even contradict its own interests. The answer to this question is the fact that this arrangement is organized by the government. That is why it is called “mandated by government” (Lecraw, 1989, pp47). “Mandated countertrade is a policy to restrict unilateral imports” (Ellingsen and Stole, 1996, pp 67). In most cases it is the government of the importing country. So, this is the decision of the government, not of the participants (Lecraw, 1989).

Government doesn't allow making purchase of goods from foreign firm unilaterally (Fletcher, 2009). Such purchase is allowed to make only on a reciprocal basis, it means that government prohibits the import without a corresponding counter exports (Ellingsen and Stole, 1996).

Government uses several tools to implement this rule in life. The most effective instrument, which is used by government in this case, is “allocation of foreign exchange” (Ellingsen and Stole, 1996, pp 68). Another one tool is “to grant import licenses” for some products, such as for example weapon (Ellingsen and Stole, 1996, pp 68).

With help of mandated countertrade, government wants to encourage import of high quality products or product of strong demand and help domestic producers to get rid of poor quality or poor demand products (Ellingsen and Stole, 1996). The government coordinates the activities of importers and importers of particular transaction, taking primarily care about the

national interest of their country, and trying to increase the export of domestic products in order to give a boost to economic growth (Lecraw, 1989).

3. Forms of the Countertrade

It is very difficult to give the accurate determination, which can embrace all features of Countertrade. Characterizing its forms will help to understand how Countertrade works.

The figure below shows how the CT functions and briefly explain the essence of each type of the countertrade.

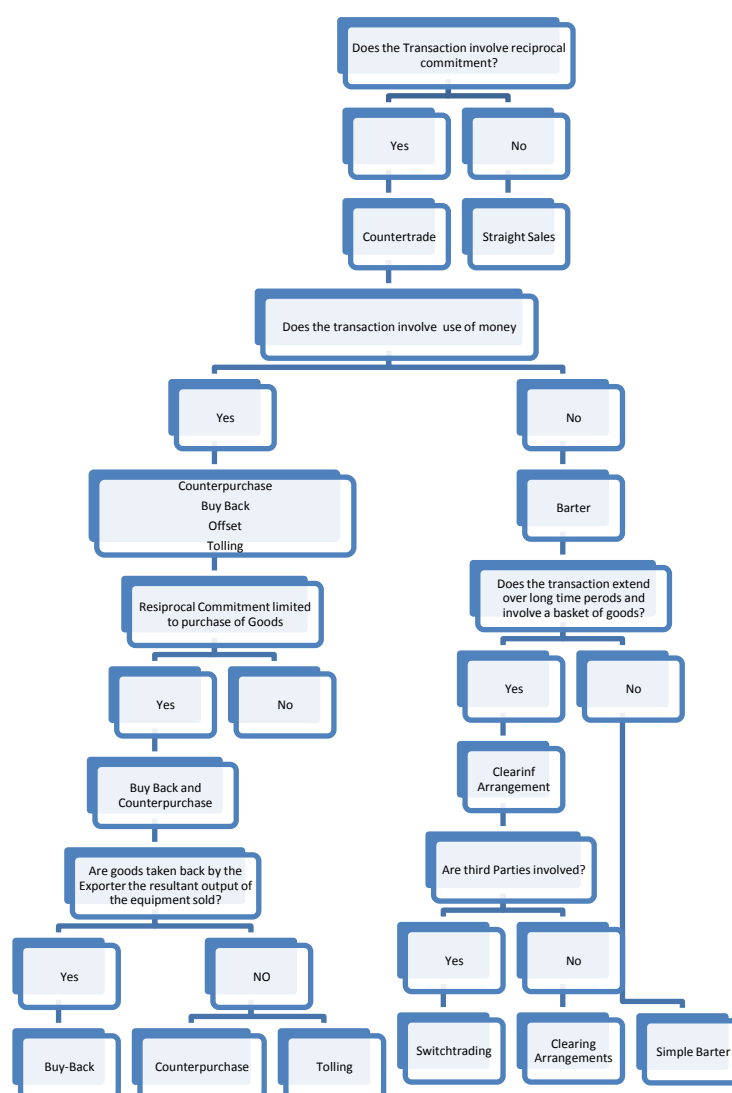


Figure 4. Essence of the countertrade.

Source: Hennart J.F. (1990) pp 245

3.1 Barter-Trade

Barter – trade is a direct (with no one in between), reciprocal, single, one time trade of products, goods, services or technology, (Ravas, 2011) which is based on the same wants of both sides of the agreement (Paun, 1997; Kham, 2002; Lecraw, 1989; Palich, Ireland and Bagby, 2001). In most of the cases, barter is a short-term agreement, with duration of only about three or four weeks. Barter is the one of the most important form of Countertrade, which is mostly used to solve the problem associated with the shortage of foreign currency.

Barter is the oldest and “simplest form” of countertrade (Chao, 1980). As it is a onetime arrangement it includes only one contract (Sumer and Chuah, 200; Palia and Liesh, 1990). This is an arrangement mostly only between two partners, but in recent years the need for intermediary grows, because it became very difficult to find two partners whose wishes regarding the goods are completely coincide. Many trade partners often resort to the assistance of a mediator who works in turn with many other partners and has a large number of products at their disposal, where everyone can chooses products they wish (Sumer and Chuah, 2007).

There is no money involvement and that’s why there are no specific prices in barter arrangement (Hennart, 1990). Barter allows countries to import goods without the involvement of foreign currency and without the accumulation of debt. (Papadopoulos, 1993) All these, makes Barter one of the easiest form of the Countertrade (Sumer and Chuah, 2007).

As already mentioned above, wants of partners about goods need to match, and that is the main difficulty (Papadopoulos, 1993). Despite the fact that is often very difficult to match such needs of both sides, barter is very popular and is the oldest type of trade in mankind history. People have traded by exchanging goods or services, before money has been implemented (Balu and Norfadilah, 2002). And despite all the difficulties of this type of trade, barter takes more than 8 per cent of global trade (Sumer and Chuah, 2007).

So called “Simple Barter” is a trade where goods will be changed for goods (Papadopoulos, 1993) just of the same value (Camino and Cardone, 1997; Nassimbeni, Sartor and Orzes, 2014).

There are two types of barter existing:

- *true barter*, where exchange of goods or service is taking place without putting value on them;

- *valued barter*, with the value on exchange products or service. (Figure 4)



Figure 5. Types of Barter.

Source: Sumer M. and Chuah J. (2007)

These are essential component in the barter transaction, as the value of the product for both sides may be different. And this can lead to conflict between the parties or even invalidates the transaction (Sumer and Chuah, 2007). It means the value of the exchanged goods must be the same for both sides of the agreement.

Barter helps to reduce risks concerning currency value and uncertainty concerning the price. Trying to reduce some risks with using this type of countertrade, agreement partners carefully describe the quality and quantity of the countertraded products (Robert, 1989).

Good example for Barter is German Volkswagen, who has sold around 10000 cars to East Germany in early 1980's and has gotten other goods from East Germany (Aggarwal, 1989).

Barter arrangements are very common among countries, which produce oil, Eastern and Western countries. There was a big barter of over \$1 billion worth, between Saudi Arabia and the United Kingdom, where oil has been changed for 10 Boeings 747. Also Iraq and Libya has bartered oil for arms with Soviet Union (Al-Suwaidi, 1993).

Nowadays, barter agreements are often made on “government – to government basis”, where incentives might be more political than commercial (Balu and Norfadilah, 2002). Good example for such governmental agreement was the barter deal between Russia and Cuba, where oil from Russia has been changed for sugar from Cuba (Gurban, 2005).

In some countries barter plays a crucial role. One of such countries is Argentina, where since 1997 there is an extremely unstable economic situation. Because of huge economic collapse Argentina was unable to pay for the import, rate of unemployment grew drastically and poor people had to barter goods and services just to be able to survive (Gurban, 2005).

Company of Britain supplied the Soviet Union Pepsi Cola and in return received vodka "Stolichnaya", which was later sold on the European market (Aggarwal, 1989).

3.2 Counter purchase or Reciprocal Sales

Similar to barter arrangements, partners of the counter purchase buy goods of the same value from each other, but actual trade happen not at the same time (Paun, 1997). In normal case, there are two separate contracts where one partner, exporter sells goods or services to the importer and buys other products of the same value from importer (Al-Suwaidi, 1993; Palich, Ireland and Bagby, 2001). Payment is made by one partner by credit or in cash and another partner pays in goods (Camino and Cardone, 1997; Khan, 2002).

“Classical Counter purchase” arrangement involves “two parallel money-for-goods transactions” (Papadopoulos, 1993, pp 17).

Counter purchase usually consist of three particular agreements: “primary, counter purchase, and fulfillment” (Al-Suwaidi, 1993, pp 277).

- Primarily agreement is like international standard contract.
- Counter purchase agreement is consists of agreed terms.
- And the last one, also called protocol, describes acquisition of goods, where neither prices nor currency are usually conditioned (Al-Suwaidi, 1993; McVey, 1981).

Very often counter purchased will be materials for manufacturing and raw materials (Oh, 1985).

Counter purchase are usually profitable for both, developed and developing countries.

Developed countries use profitable counter purchase to maximize the export to other countries. Developing countries use counter purchase “to minimize their balance of payment deficit” (Oh, 1985, pp 119) from goods which were imported. (Ravas, 2011)

Good example of counter purchase is an American company of equipment construction, has sold \$10 million of machinery for road construction to the government of Indonesia. And in return, company from the U.S. has bought “sourced goods” from Indonesia of about \$8 million within next five years.

In 2008 China has supplied Democratic Republic of Congo with the equipment and plant for copper mine building, and must have been paid back by the cobalt and copper from this mine (Howse, 2010).

In case if one counter purchasing side don't meet the actual counter purchase, it has to pay a penalty, which normally has to be foreseen in the contract (Hervey, 1989).

3.3 Buy-Back or Compensation

Buy-back is the most widespread type of the countertrade (Mirus and Yeung, 1986).

This is an arrangement between the importer and exporter, where exporter supply with plant and equipment and as a partial or full reimbursement commit himself to buy the product, which were produced with help of these plants and equipment “over a given number of years” (Camino and Cardone, 1997, pp 104). In many cases, the importer though, pays return with goods of local origin which are not necessarily manufactured with help of imported machinery (Paun, 1997; Camino and Cardone, 1997; Khan, 2002; Al-Suwaiddi, 1993; Milenkovic-Kerkovic, 2004). Exporters are usually western companies, exports technology and equipment; in return usually they obtain products, which were resulted from the delivered equipment. Such products are usually produced according to the exporter from western (Oh, 1985). If the importing country manage it to produce goods in a good quality, which will be sold later on a western markets, both sides will benefit from this deal (Hennart, 1990).

This type of countertrade helps the country which import the technology or plant equipment to cope with the debt, which were arisen from the capital import (Papadopoulos, 1993; Mirus and Yeung, 1987).

Buy back was very popular in early 1960s and still mostly used when huge amount of goods have to be countertraded (Al-Suwaiddi, 1993).

Buy back agreements are usually last for many years and involves much more risk and higher monetary value as for example barter (Al-Suwaiddi, 1993). The main risk falls on the exporter who receives payment for the goods not immediately, but over the next few years. Next risk of the exporter is inability for exporter to check the quality and condition of the goods which he is going to get in return for their machinery and plant (Balu and Norfadilah, 2002).

Buy back will be often considered as kind of investment in the economy and will be used in order to avoid transaction costs (Hennart, 1990; Mirus and Yeung, 1987; Marshall and Wynne, 1996).

If in the buy back agreement the exporter borrows hard currency in addition to plants and machines, it will have to be given back as soon as it begins to generate income (Mirus and Yeung, 1987). In this kind of situation, the problem with the currency saving remains but importing country will be able to get the latest technology.

In U.S. buy back is known as “direct compensation agreement” (Balu and Norfadilah, 2002, pp46). General Electric exported machines for the production of medical equipment to Poland; in return General Electric has received the “electrocardiogram meters”.

One company from America called Occidental Petroleum helped to construct the plant of ammonia in Soviet Union, in return to buy the products of ammonia for next 20 years (Al-Suwaidi, 1993; Hervey, 1989).

3.4 Offset

Offset one of the most important, frequently used, long-term arrangement. Since there are political and economic interests intertwined, it is also very complex arrangement (Hennart, 1990; Sumer and Chuah, 2007; Taylor, 2012). Offset is one or more trade agreements, where exporting company grant more skills, products and services, besides the acquisition order (Al-Suwaidi, 1993).

“Offset enables the buyer to “offset” their purchase by securing sellers purchase of products from the buyer, help the buyer sell products, or participate in joint ventures. The main concept is to “offset the negative effect of large purchase from abroad or the current account or to avoid hard currency depletion” (Paun, 1997, pp 42).

Since offset is a form of the countertrade there is part of reciprocity included, often between a supplier from another country and the government (Taylor, 2012). Offset is one of the most obvious political and economic connections of interests. With help of offset countertraded will be high value goods, new technologies like aerospace, marine and transportations helicopters for civil and defense purpose (Nassimbeni, Sartor and Orzes, 2014).

Table 2. Industrial sorting of base product.

Industry	% of total
Aerospace	48, 51
Autonomic	9,90
Communications	4, 95
Electronics	4, 46
Energy	1, 49
Environment	0,50
Financial	0,50
Industrial	1,98
Marine	10, 98
Mining	0,50
Munitions	9,41
Specialty metals	0,50
Transportation	6,44

Source: Taylor T.K. (2012) pp 27

The table above shows the industrial sorting of base product, and confirms the fact that offset is very popular and widely used. The industry of aerospace forms the biggest percentage of all offset arrangements, about 48% (Taylor, 2012).

Offset is a type of countertrade, where company which exports its goods has to intermix components which were locally produced into the product to provide. “The seller has to agree to subcontract of the production to local producers, to increase its imports or to transfer technology” (Camino and Cardone, 1997, pp 104). Such products are very often the product of a military nature (Papadopoulos, 1993). Offset is known for trade with arms, as “defense offset” (Sumer and Chuah, 2007). It is one of the biggest “arms agreement” on the international level. About 130 countries have already accepted offset policies.

Europe is the biggest supplier of the offset arrangement. The second biggest supplier is North America (Taylor, 2012).

Under the meaning of the word “offset” a large number of exports will be understood, which are often practiced by international corporations. Offset is often used to:

- reduce spending on imports of high-level;
- improve the state of the industry;
- do less dependence on international importers;
- increase the number of jobs;
- increase exports (Khan, 2002).

“The goal of the offset system is to counterbalance the loss of domestic and economic activity or domestic capability in exchange for the privilege to be a defense contractor in the applicable country” (Nackman, 2011, pp 18).

Offset “is not an alternative form of payment” (Al-Suwaidi, 1993, pp 280).

There are two types of offset distinguished by the literature: direct and indirect offset (Ravas, 2011).

“Under direct offset arrangement, the components of sold item are to be produced within the buying country and the seller agrees to buy these components to use them in-house”. (Khan, 2002, pp 18) Importing countries use direct offset to improve the domestic industry, to stabilize domestic employment (Balu and Norfadilah, 2002). The most used type of the offset is the direct offset (Taylor, 2012).

Indirect offset – if the export country agrees to accept “unrelated products” from the importing country. Such type of offset agreement helps the importing country, mostly developed country to “claw back some of the cost of the import” (Balu and Norfahdilah, 2002, pp 46; Khan, 2002).

As practice show, in most cases offset arrangements are agreed by governments. But there are also many offset arrangements among private organizations (Nassimbeni, Sartor, and Orzes, 2014). Governments have earlier used offset when they needed a large supply of military equipment, but later it became very widespread in other segments like deals about telecommunications or commercial aircraft (Ravas, 2011).

Developed countries normally use offset for acquisition of military and aircraft equipment (Oh, 1985). According to J.F Hennart (1990) countries that use this type of countertrade are often small but rich, who can afford to purchase weapons (Hennart, 1990).

Offsets are normally countries, which have “high investment potential” like Saudi Arabia. Saudi Arabia has offset agreements, which involves exchanging oil often for military equipment. According to Saudi Arabia’s regulation, exporter has to invest 35 percent “of the cost of the technology and services in an industrial joint venture or new joint venture created specifically for the purpose” (Al-Suwaidi, 1993, pp279). “Exporter has to put resources into the country, not taking such resources away” (Al-Suwaidi, 1993, pp 80).

Another example for offset agreement is U.S. fighter airplanes to Japan with using offset with the proviso that some components of these aircrafts were made in Japan (Hervey, 1989).

Exporter doesn’t violate the rules, even if he works with various firms and companies. It is provided by the offset agreement as long as these arrangements occur in the same country. Thus, the exporter has the opportunity to use much more goods and services (Palich, Ireland and Bagby, 2001).

3.5 Switch trading

Switch trading comes to existence when exporter has some credits from countertrade arrangements and don’t want or cannot use them, he can sell them to an intermediary, at a discount price (Palich, Ireland, Bagby, 2001).

Switch trading is a double-sided agreement which helps to regulate financial requirement that come into existence in connection with the export and import. Clearing accounts are not flexible due to the fact that they bind countries to the bilateral arrangement. Switch trading helps to avoid such inflexibility” by allowing a country in surplus to transfer its purchasing rights to a third party and in this way introduces an element of multilateralism” (Papadopoulos, 1993, pp 17). Switch trading occurs when one country, which has “the surplus clearing credits” have to sell a part or all of its clearing accounts to an invested third party at a lower prices (Oh, 1985, pp 122).

Switch trading agreement includes at least three partners and is increasingly seen not as trading form, but as particular payment method (Sumer and Chuah, 2007).

In connection with the use of barter, country received the goods, which it cannot use or sell at home in full price. In this situation, a third party buys these products at discount prices, so switch trader has a responsibility over these goods. This is very complicated process, where switch trader has to “go through several additional countertrade transactions before all countertrade obligations are settled and a final hard – currency transaction is completed” (Hervey, 1989, pp 19-20) “The third party is often a switch trading house which uses the credits to buy goods from the country in deficit” (Oh, 1985, pp 122).

After many intricate deals “switch trading house” receives products, which were sold for “hard currency” (Oh, 1985, pp 122). Many developed countries have both-sided clearing agreements. Iraq, for example, has both-sided agreement with Greece. France has “special arrangements” with their colonies (Ravas, 2011, pp 227).

There are many cases with “uncleared credits” which occur in long term both-sided arrangements. For example, once Brazil had a big credit abandons with Poland. This abandons could be sold to a third party, like for example UK, so that exports from United Kingdom to Brazil could be paid from the sale of goods from Poland to the United Kingdom (Ravas, 2011, pp 227).

Almost all the countries of the Third World have widely used this type of countertrade, and not only among themselves. They also often work with more developed countries (Oh, 1985).

3.6 Tolling

Tolling is coming to existence when producer is not able to get the raw materials, to serve qualitatively his customer, and the reason for this is the foreign exchange shortcomings. In tolling agreements a supplying side give the raw materials, hires the plant to transform “finished goods” out of that raw materials. All these “finished goods” will be sold to a “final customer” who pay in hard-currency. During these processes, the supplier keeps the ownership of materials, which has been used (Ravas, 2011, pp 226).

3.7 Most common type of the Countertrade

All forms of countertrade have one common characteristic, and that is reciprocity. One party delivers the goods and agrees to receive goods on the same value in return (Hennart and Anderson, 1993; Marin and Schnitzer, 1995).

Mankind's priorities regarding the international trade have been changed over years, mostly because of constantly changing opportunities and desires of the people and countries. From the ancient times one of most frequently used type of CT was barter as barter agreement has never included using of money (Chao, 1980; Sumer and Chuah, 2007; Balu and Norfadilah, 2002). The meaning of such transactions was only in exchange of one commodity or service for another (Sumer and Chuah, 2007).

According to empirical research Hennart (1990) the most used type of countertrade at that time was counter purchase, the second place was occupied by the use of the buy-back. Offset enjoyed the third place of popular by surveyed companies (Fletcher, 1996).

According to Caves and Martin (1992), mainly used forms of countertrade are counter purchase and barter, where exporter has to acquire goods from importer as well, in the same value.

According to Fletcher (1998) regarding the form of countertrade that have been used by 1998 on the first place were counter purchase, than buy-back and offset.

4. Theoretical concept of the Countertrade

Countertrade is a very complex kind of behavior on the international level. Consequently, there are many approaches regarding this subject. One of them is Network Theory and the next one is Transaction Cost Theory.

4.1 Network Theory

There are several ways to approach the countertrade. One of them is to consider the forms of countertrade and another approach is to consider the so-called "network" (Fletcher, 1996).

Countertrade itself consists of different sets of "networks" which means networks of agents, who participated in the CT. The main essence of this approach is the relationship between the actors who are involved in countertrade agreement. Also to understand how these actors work with each other and how they get their information about each other (O'Toole and Donaldson, 2002). There are two main features of the network which were highlighted: interconnection and relationships, which in turn the most important characteristic of CT as well. This theory considers such issues as:

- Development of relations of actors that have occurred as a result of countertrade arrangement.
- Would relationships generally occur without CT?
- Is the continuation of these relations after the end of the transaction possible?
- Does the fact that CT is mandated can affect such relationships?

Some basic theories, like network theory and transaction costs theory have been used by researchers to be able to explain motives and methods of company's internationalization (Hosseimi and Dafbar, 2012). Internationalization process is very complicated and cannot be explained with help of only one theory. Some researchers, like Fletcher (1996) consider network relationships as their framework, another researchers consider network perspective as a possible variable, which might lead to internationalization (Hosseimi and Dafbar, 2012).

Networking cooperation promotes the internationalization. Networking approach helps to reduce the risks concerning the foreign market entering, minimize the costs tied to investments and enhance the internationalization efficiency. Network can very good explain the models of modern business. There are some models have been developed:

- *European Networking Model* covers all theories, which were developed in universities in Europe and describe networks' individual mechanism and industrial elements.
- *Interaction Model* focused on interaction between environments, actors and atmosphere. The aim of this model is to analyze the collaboration between the supplier and the buyer in manufactured market. Political or institutional environment influence such cooperation, these are macro elements. Microelements are dependence, closeness, and expectations. All these factors affect individuals and organizations.
- *ARA Model* is focused on interaction between actors, resources and activities. Actors are individuals and firms, who have control over resources and use them to produce a value. All three elements are very connected with each other. The main goal of this model is to explain the business relationships, which are based on resources and activities in the way to help them to use resources for producing the value (Hosseimi and Dafbar. 2012).

Network-based internationalization approach developed by Mattson and Johanson (1988), explains the companies' internationalization in respect that environment is the market and business network. According to this model, firms are involved in the network and their process of the internationalization is very much affected by all these networks. In point of fact, companies' networks forecast their domestic or their international activities (Johanson and Mattson, 1988).

Johanson and Mattson (1988) assigned the internationalization as development process, which has three stages:

- *Expansion of the market*, find new markets;
- *Market invasion*, improve attitude, which is already exist;
- *Integration of the market*, establish harmony between divers market position.

The position, which the firm has in the market, in the network, is the most significant element for internationalization. Such position depends on two key elements: internationalization degree of the market, network and firms' internationalization degree.

There are four firms' market positions existing:

- “*Early Starter*” - in most cases on this early stage firms are supplier. They have not many interactional relationships, and no experience in doing business abroad and that is why the internationalization level of such firms is low.

- “*The Lonely International*” – degree of internationalization of the firm is relatively low. Firm still need more information about its network partners to be able to adapt to the market and make needed adjustments.
- “*The Later Starter*” – firms have comprehensive relationships with their foreign partners, using the help of their suppliers or competitors.
- “*The International among Others*” – firm is already active internationally, it has enough knowledge and experience concerning the international market. At this stage firms usually have “tight networks”, which makes it easier to get the “external resources” and enter a third country (Hosseimi and Dafbar, 2012, pp 188). (Figure 6)

		Degree of the market Internationalization	
		Low	High
Degree of the firm Internationalization	Low	Earlier Starter	Late Starter
	High	Lonely International	International Among Other

Figure 6. Market positions of the firm.

Source: Hosseimi and Dafbar, 2012, pp 188

Holmlund and Tornroos (1997) have identified at least four major characteristics of the relationship:

“*Mutuality*” – is about communication, dependence, trust and cooperation between the partners.

“*Long-Term Character*” – is about how relationship become long lasting and durable.

“*The Process Nature*” is about cooperation that forms relationship such as e.g. exchange of products or service.

“*Context Dependence*” is very much associated with the “embedded nature of actors” and interaction between them.

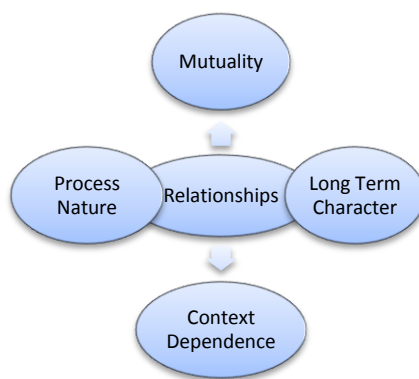


Figure 7. The main characteristics of the network relationships.

Source: Holmlund and Törnroos (1997)

Helinen and Törnroos (1998) identified six types of embeddedness. (Figure 8)

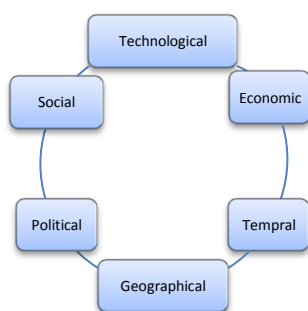


Figure 8. Types of embeddedness of the network.

Source: Helinen and Törnroos (1998)

There are not many case studies, regarding network theory. There were found only two studies that directly examine network paradigm to CT, one of them has analyzed cooperation of Royal Australian Navy and Swedish Kockums Marine. This case study has shown that countertrade agreement involves already existing networks for some actors, and “new networks” for other actors. This is because such cooperation of these two companies would have no place to be without CT.

The second example of the relationship and CT and the network was about cooperation between Indonesian Focal Company, their bankers, suppliers, government, subsidiaries from

Singapore and many indirect relationships. The cause of the network in this case was the problem, which could be solved only with help of countertrade.

In some cases, the relationship arose before CT but some of them certainly appeared only because of CT and without countertrade would not appear. Some researchers represent the opinion that networks which have emerged due to the CT agreement differ significantly from those which have emerged outside the CT agreement. In both cases:

- the use of countertrade has led to complexity and this in turn leads to the creation of new relations;
- countertrade made it possible to enter the international market, without CT it would be much harder to manage;
- networks had quite unique characteristics, the cause of which was the need to use the countertrade;
- in both cases, the government has taken an active part in the CT transactions, which has in turn affected the cooperation of actors (Fletcher, 1996).

As a conclusion on this issue can be said that need to use the CT pushed actors towards internationalization. And this applies to both sides of the agreement.

Due to the countertrade transaction, new relationships occur, and if those relationships already exist, they certainly change because of CT. Often actors which are involved in the CT arrangement, are of the opinion that all their relationship will exist as long as there is a deal, although experience shows that at least one party of the transaction, and often both want to continue the commercial relationship (Fletcher, 1996).

With help of the Network Theory it is became possible to analyze and understand how a CT transaction works, its essence. Highlight its key features and understand how actors working together affect the outcome of the transaction (Fletcher, 1996).

4.2 Transaction Cost Theory

The most important characteristic of the countertrade and the main motivation to use this type of trade is its reciprocity. Another motivating advantage of the countertrade is a minimizing of transaction costs. Many international trade participants contemplate how to avoid high TC,

and still act internationally. There are two ways to do this; the first one is to Multinational Enterprise (MNE). The second way to reduce the transaction costs on the international level is to use countertrade (Marin and Schnitzer, 1995).

Since the transaction cost has a negative impact on international trade, it's obvious that many try to avoid or at least reduce it. One effective way to do this is using the countertrade, where one party delivers the goods, and receives other goods in return (Amann and Marin, 1994; Hennart, 1989).

There are two cases when the transaction costs are incredibly high. First it when there is strong information asymmetry between business partners. And the second case is when there is a poor economies of scale and the country needs "transaction – specific investment" (Hennart, 1989, pp 133).

In the first case it is necessary to say that the information and knowledge make partner who owns them much stronger. It means the seller knows more about the product than the other side does, which leads often to opportunistic behavior. Sellers using his position, talk only about positive characteristics of their goods, usually concealing the truth. Often this behavior of the seller will be practiced when there is no interest in further business relations. Of course, there are some clauses, which protect the buyer from a situation where the seller has hidden important information about the product, or were hidden problems related to the plant or machinery. In the case of buy-back, where the exporter receives in return the products which were manufactured using exporters' own technology, they will certainly be interested in the quality of these products as in exported technology (Hennart, 1989).

As already mentioned above the second reason why the TC is high are: poor economies of scale, need of "transaction-specific investments" (Hennart, 1989, pp 138). The examples in this case are the countries that mine certain types of minerals. Country – miner invests into the extraction of minerals then sells them often to client. In such cases, the buyer often knows that he is the one, and may try to understate the price. So, it is advisable for the sell-side to establish long-term commercial relationships with the buyer. Western investors like to invest in the mines, and in return receive extracted raw materials over the next few years. Such agreements are usually long-term. In these situations, the countertrade can certainly replace the FDI, which means such contracts as "loan-and-import" replace FDI and helps the countries where FDI is limited (Marin and Schnitzer, 1995). Namely, another reason why the country usually resorts to the use of CT is the limited FDI. And since the countertrade also

implies a reduction in TC, CT can be an appropriate substitution for the FDI. The reason why the particular country have such FDI restrictions, are risks associated with the political situation in the country. Unstable political situation leads to the fact that there is no one who would be willing to invest money into such country. Then this country resort to the use of countertrade, as a worthy alternative to FDI (Hennart and Anderson, 1993).

All kinds of international trade is directly dependent on credit, if a country is creditworthy it can afford the import of goods and in general it is able to fully participate in the international common trade (Hennart and Anderson, 1993). However, such problems with country's creditworthiness pushing it to use countertrade as a way for internationalization.

It is a well known fact that very often only because of the high transaction costs, many refuse to participate in international trade (Hennart, 1989). So, transaction cost theory helps to understand how these TCs affect the participation in international trade transactions, and also help us to understand why such transactions don't take place. TCT explains how to increase the number of CT transactions and increase satisfaction of business partners (Hennart and Anderson, 1993).

Many researchers have concluded that countertrade is often used by those countries which have problems with the economy, and in the case of imperfect market. So these countries to be able to avoid limitations of any kind are using CT very widely (Papadopoulos, 1993). Another good reason is the transaction costs, which the developing country cannot afford to pay.

Also due to many obstacles, which are often driven by government, in developing countries, like for example internal prices which do not have any relation to international prices, and due to "imperfect information about the market", extreme TC, adversely affect the FDI. (Papadopoulos, 1993, pp25) And the reason is the reluctance of international firms to invest in a country with these kinds of problems. Such countries are often developing countries, that restrict FDI, resorted to the use of tow-way trade. In most cases, they prefer to use counter purchase and buy-back (Papadopoulos, 1993).

Initiators with help of countertrade are trying to fill the gap between FDI and their export (Egan and Shipley, 1996).

5. Motives for use Countertrade Transactions

Each party is guided by its motives which drive them to use of CT arrangement. In this part it will be examined which countries or firms often resort to use of CT and how they are motivated.

5.1 Motives for developing countries

The more the state planning is comprehensive the more those countries use countertrade (Hennart and Anderson, 1993).

According to Fletcher (1998), the degree of importance of countertrade for developing countries is much higher than for developed countries. Developing countries are very interested in this kind of trade and actively engage in it, far more than developed countries. Also “newly industrialized” countries, such as Korea, Singapore, China, Mexico, Brazil and Indonesia actively practice countertrade with Canada, Austria; Sweden, Japan and Switzerland (Aggarwal, 1989; Oh, 1985).

Countertrade provides an opportunity to get rid of excess merchandise, with help of countertrade they will be sold at a discount price, often to countries that are developing and thus sometimes have a negative impact on other markets (Papadopoulos, 1993).

Many argue that countertrade promotes the expansion and development of exports, which in turn contributes to the development and growth of the economy. Countertrade helps the developing countries to get around the limitations associated with foreign currency, which are typical for such countries, and to solve problems associated with it. Although, countertrade helps to avoid some of the problems associated with the lack of foreign exchange, it doesn't solve the problem thoroughly (Papadopoulos, 1993).

Also countertrade helps to avoid negative aspects that are related to “international loan system”, supporters who are often developing countries (Esteban de la Rosa, 2011).

If the country is looking for additional resources required to finance and credit is expensive and leads to an increase in debt, the country decides to use buy back arrangement to finance. Such cooperation allows poor countries to provide themselves with the necessary equipment and pay for it in goods manufactured using this equipment (Robert, 1989).

5.2 Motives for developed countries

Developed countries often pursue their goals using CT (Khan, 2002). They usually:

- Try to avoid limitations, caused by the government, who prohibit the import of foreign products, most often this occurs in developing countries.
- Expand their trading opportunities and establish trade relations with developing countries.
- To consolidate the acquisition of raw materials from developing countries at relatively low cost. These raw materials are usually needed for domestic industry (Halbach and Osterkamp, 1989).
- Countertrade is an effective way to gain investments and other prolonged economic advantages. Consequently, countries engage firms from abroad to shift technologies, to build plants, to establish a joint venture and create many other long-term benefits, which eventually have a positive influence on the local economy. (Al-Suwaidi, 1993)

Motivation for using countertrade for developed countries does just not want to have “foreign ownership” in their own country. That means, if the country itself restricts the FDI it is likely to resort to the use of CT (Hennart and Anderson, 1993).

5.3 Economic and financial motives

The most important difference of countertrade from other agreements is the fact that countertrade helps to solve many economic problems of counties which have decided to take part in it (Esteban de la Rosa, 2011).

Recalling the earlier studies, the countertrade makes it possible to gain the access to new markets, often to the closed markets. Countertrade helps for a company or country to make their own product more attractive and more competitive (Yavas and Freed, 2010). Also it helps to explore the world market situation, on what kind of product and where demand is growing, or what kind of product has to be better removed from the sales (Fletcher, 1998).

Additional to these, countertrade helps to overcome the barriers, which related to the trade and problems associated with foreign currency (Fletcher, 1998; Egan and Shipley, 1996).

Large international forms use countertrade to circumvent trade barriers and strict international regulations, which can adversely affect profits (Fletcher, 1998).

Also if a firm or country wants to avoid the risk associated with the change of currency depreciation or changes in prices for goods, then it is better to resort to this kind of trade (Robert, 1989).

Countertrade helps to avoid international agreements relating to the control of prices, because countertrade helps its partners to practically “hide” the real price for particular product or service, which are usually controlled by particular international agreements (Papadopoulos, 1993).

Countertrade increases trading by penetrating into different kind of markets, which in turn makes export more diverse. The reason of penetration in a variety of markets is the careful study of “market networks” (Papadopoulos, 1993). And so, it is necessary to emphasize that countertrade is one of the most effective way of introducing the product on the market.

Overtime, the country that receives income in the form of currency from export should make sure that the casts used to import goods, must more or less coincide with the profits from exports. Countertrade guarantees coincidence of spending on imports and export earnings. That would be especially attractive for countries which have irregular exports.

Countertrade helps creditors to be sure that the debtor country is creditworthy with help of so called “credit collateralization”, which implies a use of the goods of the debtor in the form of collateral. In this situation both sides of the agreement are indebted to one another and commodity is a guarantee for the “initial import credit” (Esteban de la Rosa, 2011, pp 274).

According to Paun (1997) a lot of industrial companies are using international countertrade in terms of gaining sustainable competitive advantage.

The government can use Countertrade in order to attract foreign investment to its country (Robert, 1989).

Countertrade acts as an important financial tool, mostly for developing countries that are not able to pay for imports due to their financial problems, such as low value of its own currency or foreign currency shortage (Oh, 1985).

Using for example offset agreement the purchase of weapons, the government can put a condition that in case of sale of these weapons, part of the proceeds will be invested in the buyer’s country (Robert, 1989).

5.4 Seller's and Buyer's reasons

Almost in all cases, “compulsory request” implies compound and non-removable elements of the CT arrangement. But in some cases, such elements of the arrangement are not really compulsory. The adoption of such conditions often does offer more attractive to the seller partner (Nassimbeni, Sartor and Orzes, 2014; Paun, 1997).

The buyer has plenty of reasons to use CT (Paun, Compean and Grewal, 1997). Such as for example a desire to establish or improve the existing channels for the sale of goods abroad. Especially when there is a falling demand for this product at home and sales of products abroad plays a decisive role. Especially when it comes to perishable products, that needs to be sold (Nassimbeni, Sartor and Orzes, 2014).

5.5 Political reasons

Government plays a major role in the countertrade; it can encourage or simply limit the using of CT (UNCITRAL, 1993). Government can act as trading partner themselves, and decide which counties are going to be their trade partners. If potential partner – country is a member of the same trade group or they will be able to complement each other in terms of industry, countertrade transaction will be more likely approved by the government (Fletcher, 1998). It should be stressed that government intervention in trade relations at only in the interests of their own country (Robert, 1989).

There must be selected several very important reasons for which the government resorts to the use of countertrade:

- To influence international relations, especially to establish close trade relations with other countries. Countertrade makes it possible to establish good business relations with other governments (Fletcher, 1998).
- To reduce the level of imports in the country and save the currency, trying to bridge the import with export expansion (Robert, 1989).
- To provide their own country with the latest technology and industrial equipment (Papadopoulos, 1993). They simply demands from the supplying party the necessary technology, to be able to improve the quality of locally produced goods (Robert, 1989).
- To approve social security for their own country.

- To attract international interest in their products or simply to enhance export expansion of certain products.
- To attract investment, linking investments to potential sale of those goods which were produced with the help of the investment. Such arrangements could be such forms of CT as offset or counter purchase (Robert, 1989; Papadopoulos, 1993; Al-Suwaidi, 1993).
- To acquire rare, expensive goods for their country (Robert, 1989).
- Also government is using CT in order to increase the number of jobs at home. If for example, the country get the technology it will need manpower that would run it, and this in turn gives rise of domestic employment. Offset is the right form of the CT to use to achieve such goals (Robert, 1989; Sumer and Chuah, 2007).

Pursuing their objectives, governments often offers also political benefits and, as a motivational boosts (Robert, 1989). For example, when government receives some defense items, such as arms, government may require the importer to agree to a joint venture on the production of weapons in importer's country, which in turn will lead to an increase of jobs.

6. Special issues of Countertrade

The aim of this chapter is to analyze which role plays financial institutions, the credit requirement and legal aspects of forms of Countertrade.

6.1 Financial aspects

In this part it will be considered, which methods will be used to finance the countertrade arrangement and which role financial institutions plays.

6.1.1 Banking Service of the CT

In connection with the widespread use of CT in the world, banks have created special “trading department”, which in turn created “advisory units” (Khan, 2002, pp 52). These units are involved in the finances associated with different forms of CT arrangements.

6.1.2 Need for financing

For example, in a barter transaction money plays no role, which is why there is no need for financing. But the more complex is the deal, the more difficult is form of CT, which means that the more there is a need for financing. Ss in some forms of the CT the transfer of goods or to payment for these goods can last for years, both sides might need some financial guarantee, i.e. “payment guarantee” (Khan, 2002, pp 52).

6.1.3 Methods for Financing

There are many methods of financing, which will be used with CT transactions, in order to minimize the time between export expansion and import. These methods are “letters of credit”, which provides defense and safety for importers and exporters (Khan, 2002; International Trade Finance, 2007; Financing U.S. Grains, 2004).

CT deals including many forms of LC, one of them is Standby Letters of Credit, is usually used to guarantee the credit, which it will be paid back. Such letters are normally very difficult to obtain, particularly if the debtor is not creditworthy.

“Transferable letters of credit” permit the trader to request the bank to transfer the whole or part of credit to the exporter. After the exporter has supplied the goods, he shows the relevant documents that prove it to the bank and obtain an already specified amount of money (Khan, 2002; pp 53).

“Assignment of debts” is usually used in CT arrangement, primarily in case when goods will be sold on discount (Khan, 2002, pp 53).

6.1.4 Credit for Buyers

Experts often connect the export to credit of the buyer just to make sure, that it will be paid for the delivery.

Escrow Accounts a mechanism which protects the financial interests of all parties who are involved in the CT arrangement (Khan, 2002).

ForFeiting was designed in Zurich and Vienna and created only for trade with countries of Eastern Europe. In recent years Forfeiting has become incredibly popular, most likely due to the global crisis and debt worldwide.

When long-term financing is required, Forfeiting Bank acquire exchange bills of the exporter, the whole his receivables, discount them all. And the buyer obtains the credit for concerted period of time.

6.2 Legal aspects

Before taking steps towards organizing the CT contract, potential partners must make sure that they understand each other, i.e. speak the same language.

6.2.1 Barter Arrangement

Recall that barter implies an exchange of goods without involving money (Paun, 1997; Khan, 2002; Lecraw, 1989). There is only one contract needed in any barter transactions. But each country - partner should have 3 additional contracts, such as insurance contract, contract regarding transportation and Standby letters of Credit (Khan, 2002).

6.2.2 Counter purchase Arrangement

It should be recalled that the counter purchase is associated with the purchase of sale of goods (Papadopoulos, 1993; Al-Suwaidi, 1993). In this case, at least two of the contract shall be prepared, which have to be linked. First contract is like usual contracts, made for classical goods changed for money. This first contract called “*Primary Sale Agreement*”. The second contract is “*Secondary Sales Agreement*” describes the obligations of the exporter, who must in turn buy goods from importing party. Sometimes third contract is compiled, which connects the two early contracts (Khan, 2002).

6.2.3 Buy-Back arrangement

Here the “*Primarily Sales Contract*” includes the actual sale of plant, equipment and machinery. It also describes all obligations regarding the use of these equipments. In Buy-Back contract should be specified how much the exporter will receive for their plant and machinery (Khan, 2002).

6.3 Governmental regulation of CT arrangement

Unfortunately to date, there is no special law which would regulate the activity of the countertrade agreement, not even on the international level (Esteban de la Rosa, 2011).

Government can and actively regulates such transactions as CT using special rules governing trade relations (Linse, 1986; Choi, Lee and Kim, 1999). For example, some imported products have to be paid only with help of countertrade arrangements (Yearbook of the United Nations Commission on International Trade, 1988). If some local products are not sold in the local market, the government allows companies to use CT, but only when using special, favorable contracts. Another restriction or rule that the government usually introduces is that not all domestic companies have the right to take part in the countertrade, and in some countries the government only decides which companies are allowed to participate in the CT.

7. Clauses, commonly used in Countertrade

Every countertrade contract must include appropriate clauses, which serve to avoid possible risks associated with the goods, etc.

7.1 Transfers to Third Party

This case takes place when one or both parties of the agreement for various reasons cannot carry it out, while the third part can bring the deal to the end without making any changes in the contract (Esteban de la Rosa, 2011).

7.1. Linkage clause

Linkage clause occurs when in the case of the both-sided purchase, exporter might request that its product might be available to buy not only for the importer, but for many other potential partners (Esteban de la Rosa, 2011).

7.1. Penalty Clause

Penalty Clause comes to fulfillment in the case if one party of the agreement does not want or cannot fulfill the terms of the agreement. In this case, this party must pay a penalty which is in most cases foreseen in the contract (Esteban de la Rosa, 2011).

8. Problems of Countertrade

As well as any transaction between the partners, not to mention a deal at the international level includes problems. This part will examine what are the possible problems and how they are provoked in CT transactions.

8.1 Product Problems

Parties who have resorted to the use of countertrade should always specify the quality, quantity and condition of the goods that should be counter purchased (Park, 1983; Yearbook of the United Nations Commission on International Trade, 1988). Product quality is a major problem in such transactions as CT (Park, 1983). If the agreement between the partners indicated only broad concept what kind of product will be counter purchased, in such cases, the quality and condition of the product is incredibly difficult to control. Contracts should accurately describe the quality, quantity and origin of the goods. If in case if one party claims that in exchange for a good product, it received the goods of poor quality, which it cannot use or sell. But supplier partner denies it. Such an agreement can come to a standstill, since there is no specific law that regulates these issues (Yearbook of the United Nations Commission on International Trade, 1988).

Problems may particularly arise with using in buy-back agreements, where one party delivers plant and machinery, and agrees to buy goods, which will be produced by these plants and machines during the next few years. In these arrangements, sides have necessarily to describe a range of products that can be produced using the delivered technology, because with these technologies the wide variation of goods can be produced. Sides should exactly describe what kind of products and in what capacity they are willing to buy (Yearbook of the United Nations Commission on International Trade, 1988; Park, 1983).

In normal cases, the qualities of the counter purchased products are precisely described in every countertrade arrangement. Return of the product because of the poor quality has to be enshrined in the contract and is regulated by clause in favor of one party or another (Yearbook of the United Nations Commission on International Trade, 1988).

In some cases even, some companies, mostly of planned economies sometimes, blend poor quality products which are in excess with the products of good quality (Park, 1983). But if the case becomes clear, the transaction usually doesn't take place and deceived partners lose

confidence in this particular company or country (Yearbook of the United Nations Commission on International Trade, 1988).

Many also argue that the use of countertrade is associated with the desire to reduce the price of the particular product on the international market. Problem which may occur with this is a quality of product. Unfortunately, developing countries are not known for producing good quality products and of course, this leads to the risk for the buy-side (Papadopoulos, 1993).

A limited number of products that can be exchanged are also a problem for the use of CT. Some products that countries want to exchange are often difficult to move to another country in the short term as they may spoil. In connection with such risk country can only sell such goods at discounted prices (Aggarwal, 1989).

8.2 Negotiation Problems

The negotiation is the most difficult and the most important phase in the whole CT arrangement. This key phase includes numerous meetings, the articulation of the interests of both sides (Esteban de la Rosa, 2011). In the early stage of the negotiations it will be determined who is going to be strong and who is going to be weak side of the agreement. If for example, at the negotiating table with the aim of CT sits private and public firms, the state firm is probably going to be in a weaker position. Especially if the product which must countertraded is very important to their economy. Although the position of the party should be measured not only by the economic conditions. It is wrong to assert that the state-owned firms are weaker than commercial. It depends on the circumstances influencing particular negotiation. Strong part of the negotiations will be often considered countries which export oil. These countries are always well informed about their business partners. They are often very powerful negotiators, which mean that they make decisions about the conditions of the particular transaction (Esteban de la Rosa, 2011).

Strong parties of the negotiations do not accept the conditions that lead to unpleasant obligations for them, and usually they avoid clauses in the contract. But in spite of all these, there is still a possibility to impose some clauses for such “strong negotiators” even it is unilaterally”. Such conditions affect what group of products will be purchased or exchanged (Esteban de la Rosa, 2011).

Usually organizations, which are dealing with Foreign Trade don't inform each other regarding the export, and which products are obtainable; sometimes even products which were put on the market can be a long-promised to another buyer (Aggarwal, 1989).

Market prices don't play any role in CT negotiation process. Agreement governed by "need" of one or the other partner, and in such cases the prices of sold production can be reduced (Aggarwal, 1989).

8.3 Uncertainty and risks

In spite of the huge number of advantages, some authors identify several drawbacks of the countertrade operations. For example Yavas, Freed and Vardiabasis (2000), stressed that countertrade operations are not always beneficial and even vice versa. Since the exchange of goods takes a very long time. Also CT holds a lot of risks, such as for example the risk associated with the product, etc. Yavas, Freed and Vardiabasis (2000) criticized the view that countertrade helps in currency shortages since almost all forms of CT imply currency turnover (Wilson, Wang, 1996; Khan, 2002; Al-Suwaidi, 1993).

Western exporter, who enters into an agreement with Eastern European countries and agrees to receive for their goods not foreign currency but goods in return, such countries runs the risk of selling the received foods in return, as the price in the currency of this product may be lower than expected or lower than western exporter spent on the origin export expansion (Al-Suwaidi, 1993).

Sometimes the price of goods in the countertrade transactions exceeds the price by 10 and in some cases by 30 percent, which of course also has a negative impact on the use of the countertrade (Al-Suwaidi, 2002). Especially for importing country CT arrangement is often too expensive and often not worth it.

For developed countries which have countertrade agreement with developing countries, risks are the lack of information, the inability of managers of having business relations with such countries, which are crucial for such business relations, especially for export in developing countries. Also the developed countries are usually not able to negotiate good trading conditions for themselves.

Using countertrade, firms are forced to use "trading house", to locate the goods, which were countertraded, which correspondingly leads to additional costs. In this situation could be said

that, the goal is not always justify the means i.e. CT is not always financially beneficial or optimal (Papadopoulos, 1993).

Hennart and Anderson (1993) had emphasized his view that the FDI can be replaced by countertrade. But this point of view has been questioned by (Papadopoulos, 1993) since it is possible to assume that the use of CT helps to reduce or avoid transaction costs, government has the option of addressing the cause of the distortion more directly, when it does so by limiting DFI. From the economic point of view, this could be “a superior policy response” (Papadopoulos, 1993, pp 24). According to Papadopoulos (1993) countertrade cannot be an appropriate replacement for FDI, countertrade is even not really depends on the FDI.

Using the countertrade, firms are forced to use “trading house”, to locate the goods, which were countertraded, which correspondingly leads to additional costs. In this situation could be said that, the goal is not always justify the means i.e. CT is not always financially beneficial or optimal.

Countertrade may be beneficial only in short-term transactions. With regard to transactions that last for many years, the CT can be very expensive and often unprofitable, due to the risks which must be taken (Robert, 1989; Al-Suwaidi, 2002; Hennart and Anderson, 1993).

9. Future of Countertrade Arrangements

Countertrade is a widely used form of trade worldwide. By the end of the eighties countertrade is more than twenty percent of all global trade. According to some sources, this percentage is now more than 30 (Aggarwal, 1989; Neale, Yesim and Pass, 1997).

While Europe and Japan have long been using countertrade, US companies began to use it not so long ago, but very intense in terms of promoting the U.S farm products, to sell weapons, and (Linse, 1986; Aggarwal, 1989).

To date, as many years ago, countertrade is very popular. And experts believe that the popularity of this type of trade relations will continue to grow (Oh, 1985).

A reason for a country or a company for choosing countertrade is the benefits that they would not have received from other commercial relations (Ravas, 2011). These benefits include new technologies for developing countries, solving problems with foreign currency, “marketing expertise” increase the demand for goods of own production, and many other significant motivating elements that are pushing the use of this type of trade (Ravas, 2011, pp227). And so, it is necessary to emphasize that countertrade is one of the most effective way of introducing the product on the market (Papadopoulos, 1993). CT increases trades by penetrating into different kinds of markets, which in turn makes export more diverse. The reason of penetration in a variety of markets is the careful study of all “market networks”.

Over time, country which receives income in the form of currency from export should make sure that the casts used for import must more or less coincide with the profits from exports. Countertrade guarantees such coincidence of spending on imports and earnings from exports. That would be especially attractive for countries, which have irregular exports.

Be as it may, the fact remains that countertrade is one of the most important types of trade and the way of doing business abroad (Aggarwal, 1989).

10. Countertrade Vs. Outsourcing

Fletcher (2009) allocated a similar type of international activity or a decent alternative to countertrade, namely International Outsourcing.

International Outsourcing it is when the company is not able to use their inputs and must resort to using inputs delivered from another country (Glass and Saggi, 1997; Egger h and Egger P, 2006).

Internationally outsourced can be goods and services. In respect of goods, international outsourcing serves as a way for the company to obtain beneficial partnerships, to enter the international market, and of course to obtain access to new technologies. In respect of service international outsourcing contribute to the revolutionary development of telecommunications. India is a good example for the widespread use of this type of internationalization, making huge investments in public education.

The most important driving force of the International Outsourcing is world-wide competition.

Such two types of internationalization as Countertrade and Outsourcing have many common characteristics. Both:

- strive for both-sided relationship;
- are based on interaction and dependency of two involved parties;
- create long-term business relationships;
- improve their competitiveness;
- use with maximum profit the opportunities, which are provided by these kinds of international activities;
- gain access to new markets;
- gain access to new technologies.

Figure below presents the holistic approach of internationalization. (Figure 9)

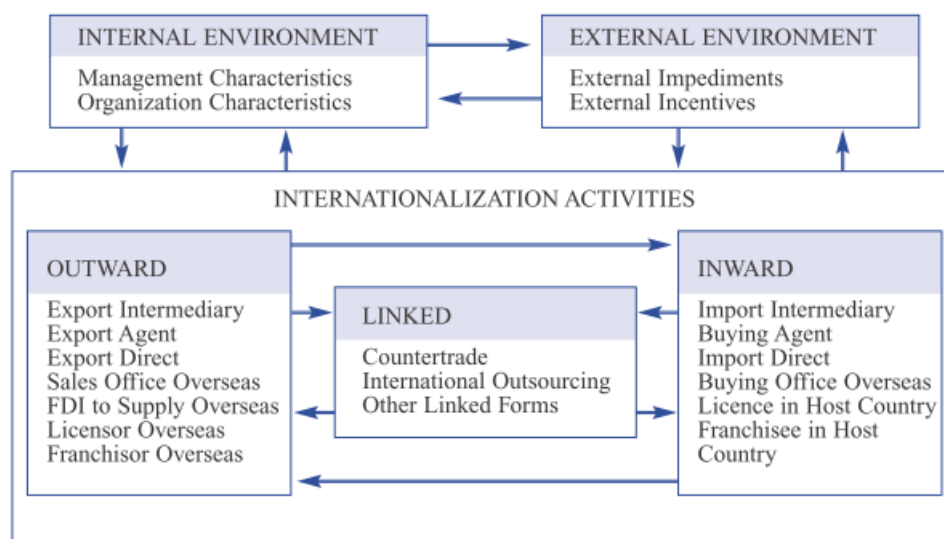


Figure 9. The holistic approach of the internationalization.

Source: Fletcher R. (2009) pp 32

The main driving forces of “linked forms of internationalization are lack of access to knowledge, reliance on long term planning, pursuit of differential competitive advantage and using personal relationships and networks as a means of overcoming environmental uncertainty” (Fletcher, 2009, pp 32).

Developed and developing countries using linked internationalization form in order to establish market abroad, to contribute to infrastructure development and to obtain the modern technology.

Despite the fact that knowledge should be easily accessible to both developed and developing countries, the facts say that there is an uneven distribution of knowledge among them. That means that there is an information asymmetry existing. There is a tendency that the less developed countries have more limited access to the knowledge, comparing to developed countries.

International Countertrade and International Outsourcing can help developing countries to get around uncertainties related to the quality of products they received, and provide permanent access to modern technology.

Also these types of international activity reduce the risk associated with asymmetrical information between developed and developing country and solve the problem of financing, faced by most developing countries (Fletcher, 2009).

Discussion

After a review of the literature related to countertrade, it can be concluded with certainty that CT plays a significant role in the international business.

The main distinction of this trade is that the export and import transactions are directly connected. Parties of this agreement can be private firms or government. Countertrade agreement is not just the exchange of goods, it is a great number of commitments and obligations, that both parties takes and a great number of economic benefits for both sides, which can be obtained only by using CT.

After studying the literature regarding the countertrade it can be enclosed that CT is not just kind of trading activity on the local and international level. The most important role of this trade is that countertrade provides the opportunity to enter the international market for countries with economic and financial difficulties, which could not be done without the use of CT. Difficulties of this kind often associated with developing countries. This explains the fact that the use of countertrade is often inherent in developing countries.

Governments of many countries actively intervene in such transactions. Protecting their interests governments restrict imports without a corresponding export. They introduce rules in by which they try to obtain the necessary items for their own country, such as modern technology and get rid of excess goods. That all means that government coordinates the activities of imports, primarily taking care of the economic interests of their country.

Countertrade has six different forms of activity. Each form in different ways helps the country of a firm to reach the international level of trade.

Barter is the oldest and simplest form of countertrade. It is just exchanging goods for goods of the same value. This form of CT may not really help to enter the international market, since it is a single exchange of goods between the two countries. But this simple form of CT performs sometimes a vital mission, as stated above with Argentina, where barter turned out to be the method for survival.

Counter purchase is similar to barter. The difference is that there is a cash flow included. But as well as barter, counter purchase is not the best choice to enter the international market.

Buy back and offset are widely used types of countertrade and unambiguously lead to the internationalization. In buy back arrangement, exporter supply with plant and equipment and as a full or partial reimbursement commit himself to buy the product, which is produced with

help of these plant and equipment, over the next few years. Exporters are usually western companies. Buy back arrangement helps the developing country to obtain the modern technology and factories become able to produce high quality products.

Offset is one of the most important and widely used arrangements. With help of offset countertraded will be high value goods, like new technologies, marine, transportations, and helicopters. Offset is known for trade in the first place with arms.

The most significant part of this research is to understand the motives for the use of countertrade. Many authors agreed on the opinion that developing countries often resorted to the use of CT, it becomes clear out of their empirical studies. Countertrade helps to deal with a number of problems that are inherent in developing countries.

- Countertrade helps to resolve problems concerning the limitations of foreign currency.
- Countertrade promotes the expansion and development of exports, which in turn contributes to the development and growth of the economy.
- Countertrade will be used as important financial tool, when developing country is not able to pay for imports due to its financial problems, such as low value of its own currency.
- Countertrade helps to deal with problems associated with low exports level, or unstable imports.
- Countertrade helps to establish or reinforce control over individual sectors of the economy.
- Countertrade helps to stabilize the prices for goods.

Also for developed countries CT plays an important role. Countertrade is an effective way of growing investments and other prolonged economic advantages. Consequently, countries engage firms from abroad to shift technologies, to build plants, to establish a joint venture and create many other long-term benefits, which eventually have a positive influence on the local economy. Developed countries usually tend to expand their trading opportunities and establish trade relations with developing countries. Another goal they pursued by using the countertrade is to consolidate the acquisition of raw materials from developing countries at relatively low cost. These raw materials are usually needed for domestic industry.

Countries and companies for various reasons, choose this type of trade. Among many benefits CT has another important advantage, namely the decrease of transaction costs. Many international trade participants contemplate how to avoid high TC, and still act internationally. One way to do this is to create Multinational Enterprise (MNE). The second way to reduce the transaction costs on the international level is to use countertrade. Another reason why the country usually resorts to the use of CT is the limited FDI. And since the CT also implies a reduction in TC, CT can be an appropriate substitution for the FDI.

And so, it is necessary to emphasize that countertrade is one of the most effective way of introducing the product on the market. CT increases trades by penetrating into different kinds of markets, which in turn makes export more diverse. The reason of penetration in a variety of markets is the careful study of all “market networks”.

Among the huge number of advantages, transactions of this magnitude as the countertrade have many drawbacks. Countertrade can be very expensive agreement and can include a lot of risk, especially if the agreement lasts for many years.

Such as if the exporter from a developed, western country binds itself to the countertrade agreement with developing country, where in exchange for its goods or service receives payment in the form of goods, too. In case of the further sale of this product in the foreign currency this western country may suffer losses.

The following risk applies to both developed and developing countries. For importing party product price may be much higher, about from ten to thirty percent.

Often due to the inability to acquire needed staff and the lack of information, developing country find itself in disadvantageous side of the agreement, and receive unfavorable terms of the transaction.

Using the countertrade, firms are forced to use “trading house”, to locate the goods, which were countertraded, which correspondingly leads to additional costs. In this situation could be said that, the goal is not always justify the means i.e. CT is not always financially beneficial or optimal.

Countertrade may be beneficial only in short-term transactions. With regard to transactions that last for many years, the CT can be very expensive and often unprofitable, due to the risks which must be taken.

One way or another, countries and firms lacking to sales resorted to use of countertrade as the only profitable way of solving their problems with access to the international market. The use of the countertrade allows them to present their products in the international market, which was not possible without the use of countertrade.

Summary

Countertrade is a general term that covers all trade relations, which are tied to reciprocity. In transactions like countertrade, export and import are directly dependent on each other.

Traditionally developed country supplying goods to a developing country and in turn, agrees to receive from this country's goods as well. Thus the exchange of goods takes place on the international level.

Countertrade can take place between private firms or governments. There are two types of CT: commercial and industrial. Commercial countertrade includes Barter and Counter purchase arrangements, industrial CT include Buy-back and Offset arrangements.

Most countertraded products are raw materials, fuel and modern technologies. Oil and gas are included in the nearly eighty percent in Barter transactions.

Countertrade is very complex kind of behavior at the international level, consequently there are many approaches regarding this subject: Network Theory and Transaction Cost Theory. Network Theory describes relationship between the actors who are involved in CT arrangement. The sense of “network approach” in the context of CT is the conception of relations, which, means the dependence of export and import on each other and collecting information about each other. Such interaction helps get an access to important resources and export their goods and services.

One of the most important characteristic of the countertrade and the main motivation to use CT is minimizing of transaction costs. Since TC has a negative impact on international trade, it is obvious that many try to avoid or at least reduce it. An effective way to do it is to use the countertrade.

Each party is guided by its motives, which drive them to resort to the CT. Many researchers have shown that primarily developing countries are using CT, but developed countries do not remain indifferent to transactions of this kind. Countertrade allows developing countries, which are characterized by a lack of currency, which in turn leads to a lack of import and export restrictions. All these factors lead these countries to use the countertrade. Each partner pursues its objectives using countertrade, basically these reasons are enlargement of sales in foreign markets, possible resource of obtaining of cheap products, to establish business relations with as many foreign-partners as possible and solve the problem of debt, which is especially relevant in developing countries.

A reason for a country or a company for choosing countertrade is the benefits that they would not have received from other commercial relations. These benefits include new technologies for developing countries, solving problems with foreign currency, increase the demand for goods of own production, and many other significant motivating elements that are pushing the use of this type of trade. And so, it is necessary to emphasize that countertrade is one of the most effective way of introducing the product on the market. CT increases trades by penetrating into different kinds of markets, which in turn makes export more diverse. The reason of penetration in a variety of markets is the careful study of all “market networks”.

Every countertrade contract should include appropriate clauses, which might reserve from possible risks. There are three clauses described: Transfer to Third Party, Linkage Clause and Penalty Clause.

As well as in many transactions, transaction between parties, especially at the international level, there are some problems arising. Such problems as: problem with product, or its quality, or negotiation problems.

Despite all the problems and risks, countertrade is one of the most important types of trade and the way of doing business abroad.

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Abstract

Das Ziel dieser Studie ist die Rolle des Gegengeschäfts im Internationalisierungsprozess zu untersuchen, und herauszufinden welche Faktoren die Entscheidungen beeinflussen, die Gegengeschäfte zu benutzen. Insbesondere erforscht diese Studie die Motive der Entwicklungs- und Industrieländer, deren politische Motive, und Gründe der Käufer und Verkäufer. Außerdem wird ermittelt, warum das Gegengeschäft so starke Verwendung findet, auch um seine Probleme und Risiken. Darüber hinaus untersucht diese Arbeit zwei theoretische Konzepte, bezüglich der Gegengeschäfte, nämlich Transaktionskostentheorie und Netzwerktheorie.

Diese Forschung umfasst alle Arten von Gegengeschäften, und ihren gegenwärtigen Platz im internationalen Handel. Sie basiert auf bereits vorhandenen empirischen und theoretischen Studien.

Verfahren zum Schreiben, das verwendet wurde, war das Studium der Literatur in Bezug auf das Gegengeschäft.

Es wurden dazu bereits bekannte Datenbanken verwendet, um Zeitungen und Zeitschriften über Gegengeschäfte in der Zeit von 1983 bis 2014 zu identifizieren.

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Sprachen

Deutsch (fließend in Wort und Schrift)
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 Englisch (fließend in Wort und Schrift)
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