

Reputation in Export Markets: Implications for Firms Capabilities and Policy

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Introduction

How can developing countries export in markets with high incomes per capita?

Low costs are an important advantage but, in many commodities, **not** enough:

1. Rich consumers have enough income to indulge in the purchase of **quality**
2. In rich countries retailing and distribution costs are very high: high rent, high labour costs, high opportunity costs of “unfilled slots” → timely delivery and **reliability** are key elements of success

Trust and Reputation

Enforcing contracts on quality and reliability is difficult – particularly so across national borders

Buyers and sellers, therefore, need to rely on **trust** and **reputation** to limit scope for opportunism

TRUST: beliefs that the other party will honour a “gentlemen” agreement

REPUTATION: a “good name” that can be leveraged with other buyers

The Main Question

What are the implications for firms, business associations and governments, of a world in which trust and reputation are important determinants of export success?

Before I share some thoughts on this, let me describe a couple of examples I have personally researched in two different papers:

- Chilean wines in the UK
- Kenyan Flowers

Chilean Wines: Background

Chile has been known to present ideal conditions for wine growing for a long time [at least from XIX century, but probably earlier]

Yet, it wasn't till about 15 years ago that the country achieved any significant role in the international trade of bottled wine.

In the early 80s a Spanish wine-maker introduced “new” equipment in the Chilean wine industry and showed “locals” that good wine could be produced at reasonable costs.

A number of domestic industrialists, who already had family vineyards, entered the business and the industry started to grow.

By the mid 2000s there are in the industry a couple of hundreds exporters and Chile had become the 5th largest exporter of wine worldwide.

Many of the early entrants, e.g., Concha-y-Toro, Santa Rita, San Pedro, Montes, Errazuriz are among the most respected wine producers in the world.

Chilean Wines in the UK

I have spent some time collecting data and talking with people on the wine industry in the UK.

The data and the interviews tell the following story about the life of a new Chilean exporter in the UK:

Initially the new winery enters the market and is matched with a “not so good” distributor, i.e., a distributor that has low opportunity costs of trying new things, discovering new producers ...

... as the winery “good name” is established, the winery moves on to a “better” distributor. As time goes by, the FOB price the winery receives for the *same product*

- i) **increase by 2-3% a year,**
- ii) **become much less sensitive to marketing cost shocks**

There are few “good” distributors in the market and, because of low product differentiation, they cannot be shared by several producers.

Common marketing by the business association tries to rectify this.

Flowers from Kenya

Flowers from Kenya provide another example in which underlying factors, cheap labour and land and good climate, gives a clear comparative advantage.

Because of flowers perishability, the industry necessitates of good airport links with Europe to develop.

Today Kenya is the largest exporter of flowers to the EU. There are about 100 established exporters, and the industry generates thousands of jobs among rural poor (especially women).

There are two ways of selling flowers:

- on the spot market in the Netherlands,
- through direct relationships with foreign wholesalers.

There are costs advantages of by passing the spot market – lower air freight costs, higher prices, more stable demand, ... but these can be realized only by establishing a good relationship with the foreign wholesalers.

Flowers from Kenya: the Value of Relationships

Together with Ameet Morjaria (and sponsored by iiG) we collected very detailed export data and surveyed firms

We were particularly interested in understanding the industry reaction to a large negative shock caused by an intense episode of ethnic violence.

Because of the violence, many firms found themselves lacking a significant share of their labour force at a short notice. We find that:

- firms prioritized exports to the direct buyers over exports to the spot market – **despite** higher prices in the market,
- among multiple relationships, exporters prioritized the **most valuable** ones,
- hence, buyers did not provide much insurance to the exporters.
- however, one year later, sellers were rewarded with **higher orders and prices** in those relationships that they prioritized

The median relationship is worth at least 10% of its yearly sales.!

The role of the business association.

Lessons from Chile and Kenya

The Chilean example provides direct evidence of the (residual) value associated with good relationships with distributors in foreign markets and is consistent with exporters establishing their name in the destination market:

- higher and less variable FOB prices.

The Kenyan example, instead, infers the importance of reputation through a revealed preference argument, i.e., through firm's choices when responding to a negative shock

- during a difficult time, firms tried very hard to protect their valuable relationships with foreign customers.

Both cases point at the importance of establishing and maintaining good trusting relationship and a good name with foreign customers.

Research in Bangladesh: Knitwear (and beyond)

Together with Chris Woodruff we are undertaking an **IGC** project to extend this research agenda to the context of the RMG sector in Bangladesh.

We want to take the agenda further, and understand:

1. how relationships with large foreign buyers are started,
2. how large foreign buyers select and retain new suppliers,
3. the importance of buyers knowledge transfers to local supplier,

We are also interested in learning about other sectors, e.g., pharmaceutical industry – another setting in which exports are expanding rapidly and reputation/brands are key dimensions of success – , jute, etc...

Implications

The Chilean Wine and Kenya Flower examples provide micro-evidence that trust and reputation are valuable in export markets. So what?

0. Costs, Skills and Management,
1. Trust and Reputation as Competitive Assets,
2. Trust and Reputation as source of Externalities,
3. Search Costs, Selection and Upgrading.

Implications 1: Costs, Skills and Management

Low costs are a necessary, but not sufficient, source of competitive advantages.

Buyers are willing to pay a price premium for quality and reliability.

How can trust and reputation be acquired?

- “trust” requires **communication** and a **common language**, this might be the (initial) role of traders/intermediaries/buying houses,
- managing relationships outside the firm is time consuming: this must be done without diverting attention from production
- it takes time to build trust and acquire a good reputation: the management of the firm must be committed to **long-term** success.
- this has implications for **suppliers** and **labour** relations as well.

Implications 2: Trust and Reputation as Assets

Relationships, trust and reputation, are valuable assets in export market.

They generate rents, in the form of higher prices and more stable demand.

As any asset (e.g., a new piece of equipment), they need to be **financed**: it might be that prices are initially below cost, or that the firm absorbs most of the negative shocks, etc ...

Access to short-term and long-term **credit** at reasonable terms is of crucial importance. It is important to realize that a good name, a trusted relationships, and so on, cannot be easily pledged as collateral.

In many contexts, reliability also require investment in expensive capital machinery.

Hence, innovative financial instruments might be required (e.g., garment)

Implications 3: Trust, Reputation and Externalities

The importance of trust and reputation implies (the potential for) externalities across firms within sectors, across sectors within countries, and over time.

“Too much” competition makes trust hard to sustain. The solution can’t be anti-competitive practices, it must be increased **product differentiation**.

The performance of earlier entrants shape beliefs about new entrants:

- how can quality and reliability be enforced?
- dynamic implications of initial misallocation
- should the **business association** promote a “supplier and buyer bureau” ?

A good name acquired in a particular sector can be leveraged to expand in new sectors (e.g., Garment => Jute).

Implications 3: Buyer Search and Upgrading

Searching and experimenting new suppliers is an important – and costly – activity undertaken by buyers.

Making that process less costly will hurt some, but will benefit the aggregate.

Too much competition on the buyers side, however, might also limit their incentives to invest and transfer knowledge in local suppliers

There might be an optimal window of opportunity where a good reputation has already brought enough buyers, but buyers are still willing to invest in the upgrading of their suppliers.

If that is the case, it is important not miss out.

To Conclude ...

... A view in which trust and reputation are important determinants of export success focus entrepreneurs, business associations, and government agencies attention on

1. **Management** and **long-term** commitment to success,
2. **Credit**,
3. Fostering **Product Differentiation** and **Common Marketing**,
4. Providing **Information** and lowering Search Costs.

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