WHITE PAPER

Diversifying Your Market, One Step at a Time

Canada

EDC

Realize a World of Opportunity

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WHY COMPANIES NEED TO DIVERSIFY

The U.S. economy has returned to health since the slump that began in 2008, but its precipitous decline highlighted the risks for exporters of over-exposure to a single market, particularly for smaller exporting companies. With the greenback gaining strength and the Canadian dollar dropping to a six-year low earlier this year, the impact the U.S. market can have on the Canadian economy has never been more evident.

For many Canadian companies, the logical response to market fluctuations and uncertainty is to diversify internationally, until their survival depends much less on the economic well-being of the United States or any other market, including Canada. The now-strong U.S. market and the regaining of lost ground by the Canadian dollar may lull small companies into a false sense of security. Ultimately, protecting a business by diversifying into multiple markets may soon no longer be a matter of choice, but a necessity.

Canadian companies have recognized the need to diversify and are taking advantage of evolving trade patterns that offer new supply, production and partnership opportunities beyond those of our traditional U.S. and European markets. They have also realized that exporting can provide benefits such as increased sales, reduced vulnerability to downturns in the Canadian market, extended sales life for products and improved competitiveness both in Canada and abroad.

Many of these companies are now operating in the emerging economies, but many more must join them if Canada is to take full advantage of the new realities of global trade.

Challenges to diversification

Expanding into international markets is no small feat for a company that has never ventured beyond Canada's borders. This is particularly the case for smaller exporters, who often lack the financial means and international business expertise to ensure success abroad. Naturally enough, these smaller firms tend to look at exporting in terms of the production, sales and distribution strategies that have worked at home.

Unfortunately, these strategies may not work given the cultural, logistical, financial and marketing challenges of international trade.

Taken together, these challenges present a company with a complex and unfamiliar context for doing business. Having a well-thought-out export strategy can help a firm fit itself into this new context and increase its chances of success overseas.

DEVELOP A STRONG EXPORT STRATEGY

For a company new to international trade, developing an export strategy starts with a careful examination of the company's capabilities. Its products should be competitively priced and be unique in one or more ways. It should have a domestic business plan of proven effectiveness, and enough human, financial and production resources to support some level of business activity outside of the country. Having strong domestic sales is also an advantage, although, depending on the company's type of business, this may not be a prerequisite for success.

In general, a company is more likely to choose the right market if it has a clear picture of its business strengths and resources. This market should be one in which the company can find a competitive advantage, a significant potential for success and a suitable method of market entry. In general, first-time exporters should look for a single, lower-risk, high-potential market by examining factors such as: country demographics, market size and composition, the local economic situation, potential customer demand for the firm's products, distribution channels and the level of competition.

Once the company has identified a suitable target market, its strategic plans will become more precise. The strategic plan should address elements such as export objectives, staffing plans, financing arrangements, major competitors and market risks, competitive advantages and disadvantages, pricing, product adaptation and the method of market entry. This last element – how to actually enter the market – can be particularly difficult as it raises questions of logistics, distribution, in-market sales approaches and whether to use local representation.

ESTABLISH ROOTS BEFORE BRANCHING OUT

The experience of successful smaller exporters suggests that trying to enter several markets at once is a recipe for failure. It is usually much better to establish a solid base in one market and ensure that the operation is fully viable before considering expanding into additional markets. A rule of thumb is that most companies will see little to no profit during the first two years of exporting, with positive cash flow beginning in year three. In difficult markets, profitability may take even longer to achieve.

FIVE STRATEGIES TO BREAK INTO A MARKET

There are five strategies that you can use depending on what you are selling and what market you are selling to. Research the market carefully to figure out which approach would work best for your company's long-term success.

1. Sell directly to customers

The most obvious entry method is direct exporting – selling directly to customers, either at the consumer level or the business-to-business level. This approach can be advantageous because it excludes middlemen, provides complete control over sales transactions and keeps the firm close to its customers.

The company must, however, find ways to make its products or services known to customers abroad and must market them in a way that will appeal to the tastes and values of a different culture.

It must also find efficient distribution methods, often in places where logistics are difficult and expensive, and deal with issues such as returns and warranties. All this can require a level of effort and expense that may tax the capacity of many SMEs.

2. Use a representative

There are several alternatives to direct exporting, one of which is to build the export strategy around using a representative – an agent or distributor, for example – in the target market.

This approach can allow companies to sell into the international market without fielding a sales force, managing distribution, providing after-sales service or coping with language and cultural barriers.

For a newer exporter, however, finding a reputable and effective representative in an unfamiliar market can be a challenge in itself. It can be hard to judge whether a candidate has the knowledge, resources and motivation to market their products effectively, and becoming locked into a flawed agency or distribution agreement can be a major setback.

Many Canadian companies have found suitable representatives by attending trade fairs both in Canada and abroad. **The Canadian Trade Commissioner Service** and industry trade associations can be additional sources for networking and information. Some companies are willing to share information with other firms about their experience with particular representatives.

3. Partner with a larger Canadian company

Partnerships can offer important advantages for a first-time exporter. Many smaller companies have become successful abroad by building a strategic partnership with a larger company that already has a foothold in international markets. Such partnerships can take many forms, from contributing to a supply chain to providing a custom product tailored to the larger partner's needs. While there may be some loss of control for the smaller company, this is usually far outweighed by the opportunity to achieve sales growth and diversification outside Canada.

Companies that have used this approach benefit by:

- leveraging the larger company's international expertise, which allows them to focus on its core competencies;
- associating with the larger company's reputation and brand;

- tapping into the larger partner's business expertise, sales force and customer base;
- taking advantage of any joint training and/or investment;
- addressing potential risks such as high entry costs, non-payment, loss of goods and limited initial demand.

To persuade a larger company to partner, the exporter needs to attract the attention of the bigger firm's decision makers. This is typically done through networking activities with industry associations, chambers of commerce and boards of trade. Once at the table, the company must demonstrate that it can add significant value to the larger company's business over the long term. The key here is to offer unique contributions such as a tailored service or product, or an ability to add flexibility and value to the larger firm's operations.

CASE IN POINT: AMRIKART

Montreal-based Amrikart provides sophisticated, precision-measurement services to major aerospace companies such as Bombardier. The smaller firm has leveraged its relationships with these Canadian manufacturers to reach customers in the United States and Mexico.

4. Follow your customer into the market

If a company sells to a Canadian business that operates in other countries, there exists an opportunity to follow that customer into their international market. For example, if a small firm sells electronic components to a company in Halifax and the Halifax company has a Mexican affiliate, the exporter may be able to sell directly to the Mexican business.

Finding such ready-made international customers can eliminate much of the risk of entering a new market abroad. A second advantage is that the exporter's business with the affiliate will familiarize the company with the local market and will give it a presence there, which in turn may help it find other local customers.

Following a Canadian customer abroad may also protect a company's sales levels if the customer shifts some or all production to an international location. It can also offer an opportunity to enhance sales if the customer's international operation leads to an overall increase in its production levels.

For companies in the service sector, following a customer can provide excellent opportunities for overseas expansion. The smaller firm can operate in a new international market, at relatively low risk, by servicing a familiar customer. This enhances its visibility in the market and can help it attract new local customers.

CASE IN POINT: MACROTEK

Despite its small size, Macrotek has built a thriving niche business by working with large mining multinationals to design and deliver air pollution control systems for mining operations. Macrotek's partnership with Sherritt International on a major Cuban project, for example, led to an invitation to participate in an even larger job involving Korean and Japanese partners.

5. Partner with a local company

Companies can also look beyond Canadian partners and instead work with local companies already operating in a particular market. Local partners can provide on-the-ground knowledge and contacts, which is immensely valuable when entering a market abroad. They can also provide gateways for expansion into additional countries. A partnership with a large Brazilian company, for example, may provide access not only to Brazilian customers but also to customers in other emerging South American markets, and possibly beyond.

In today's ever-changing and increasingly demanding global market, diversification will help insulate an exporter's bottom line from risks associated with market fluctuation. There is more than one way to enter a new market. Each company has unique needs, tolerances, capabilities and challenges. Whatever entry strategy a company does choose will need to be supported with expert advice and guidance to help provide market intelligence, gauge risk and provide financial backing.

The question should not be whether or not your company should diversify into new markets. It should be which entry strategy best suits your specific needs and goals. We will help you find the answer.

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