EXPORT COSTINGS: COMPUTERISE AND SAVE

How much do bad export costing methods cost your company in lost profit? How much do bad export pricing methods cost your company in lost orders? Chris Hensher looks at export costing and computers.

Are these questions applicable to your company? Do you admit to a more than passing acquaintance with one or more of the following traditional British costing and pricing procedures?

The "take it or leave it" formula: Ex-works cost + x% = Export sales price.

The "guesstimate" formula: Ex-works cost + x% for FOB's, + y% for freight and insurance = CIF destination price.

The "do we want to bother with exports?" formula: Normal home-market sales price + x% for "extra profit" = Export ex-works sales price.

The number of British exporters using these, or very similar, methods is amazingly large. Despite paying lip-service to the crucial importance of European and overseas business, many are unwilling or quite unable to calculate accurate prices on a delivered destination basis in Sterling, let alone in the currency of their customer.

There are eight important problems causing this situation. Fortunately, most of them can now be addressed and transformed by the application of modern computerised methods.

THE MAJOR PROBLEMS

Inertia

"We have always done it this way. It is going to cause too much trouble to change." The export executive confronted by this type of boardroom attitude at least has the consolation that those propounding it are unlikely to last very long in their jobs in today's trading conditions. It is the most difficult factor to change, but even here the introduction of computer methods in exports can be the catalyst for new thinking at various levels of the company.

Complexity of export cost calculations

An export costing can be a very complicated operation, involving a multitude of calculations on weights, volumes, quantities and different levels of revenue and cost. To undertake such a calculation manually is bad enough for somebody who understands the export cost structure thoroughly. For somebody who does not, it is more than daunting. Nor is it made easier by features like the well-known 'insurance catch'. Marine insurance is a component of a CIF or delivered price. Therefore, in order to work out a CIF price, we must know the value of the insurance. But the insurance value can only be found by multiplying the insurance rate by the CIF price which we do not know until we have worked out the insurance…

This kind of problem is easy meat for software like Exportmaster which can home in on the correct answer to the nearest cent or penny by carrying out the entire calculation as many times as may be necessary on a time-scale measured in fractions of a second. With a ball-point and calculator however, the story is somewhat different. This difficulty is precisely what tempts exporters to add 10 per cent to their ex-works price and hope for the best. But this can make your product uncompetitive.

The amount of data involved

In order to carry out an export costing, a large amount of data has to be collated. In a manual environment, this will be from a variety of sources. Packing specifications will be found on a wide assortment of sheets of paper (in varying degrees of completeness), product costs will be supplied by the accounts or production department, commission arrangements may not even be formally recorded, freight and insurance rates will be on other pieces of paper, possibly in another department, and exchange rates may depend on which newspaper the person doing the costing has with him on the day. For each costing that is carried out, an enormous amount of time and energy is expended simply on tracking down and recording the data.
In a computerised environment, the situation is totally different. All the components of the costing can be made available in a database which is accessed by the programs as required. The data is obtainable instantaneously and, when appropriate, simultaneously by different users on the system. Much of the data is accessed automatically, without a specific instruction from the user, since the program deduces from other information relating to the costing what other data is needed to complete the calculation.

Ignorance of the export cost structure

Most of a company's managers outside the export department will have no knowledge of the type and number of different costs incurred after the goods have left the factory gate. They will be equally unaware of just how substantial the effect of items such as freight can be on the profitability of a particular transaction.
Using software to arrive at the costing will force an exporting company to take all the export distribution and selling costs into account, even if these costs are not understood by the person doing the costing.

Under-estimation of relative importance of export costs

Most non-export managers fail to appreciate how heavy is the impact of freight and other costs on net margins. This often leads to the selection of a wet-finger-in-the-air percentage to cover export expenses. It can also lead to the adoption of a single price for different markets, when a proper analysis of freight costs would show that a single price would be profitable in one and loss-making in the other.

Delegation impossible

Most export managers and executives find it more or less impossible to delegate export costing and pricing operations to more junior staff or non-export personnel.

These costings are arithmetically complex and present so many opportunities for error that it is unsafe to entrust them to somebody whose accuracy is in question. Even for a mathematically competent person, a grasp of the significance of the various export components of the costing is vital if they are to be interpreted and calculated in the right way. Furthermore, the person doing the costing needs to know exactly where to find all the different data components for each item (freight rates, insurance, commissions, FOB's, etc) and which component to select in which circumstances. The chances are that, by the time the export manager has finished explaining all the details, he could have finished the costing himself.

The delegation problem can be overcome by using a computerised 'expert system' such as Exportmaster which will present the costing to the user in such a way as to force the entry of the correct data. The arithmetic is then of course carried out automatically without any question of accuracy.

Lack of time of qualified personnel

Precisely because of these difficulties of delegation of export costings in a non computerised environment, the only people qualified to carry them out are those with the least time to do them, the export managers and executives, particularly those who spend periods of time travelling away from the office.

Fear of foreign currency pricing

Most companies are frightened by the apparent complexity of pricing in foreign currencies and the danger of being caught out by currency fluctuations. Yet two software packages are available off-the-shelf, Exportmaster which calculates export prices in currencies and Metforex which handles currency and forward exchange transactions in a way which virtually eliminates the risk of loss, which can make this area of operation accessible to any company.

COMPUTER BENEFITS

We have already seen how the installation of the right kind of computer software can help with the eight major problems of export costing. It can also turn a routine clerical function into a powerful tool for increasing profitability. Here are four principal areas in which computerised costing can transform a company's export performance.

Delivered pricing

You do not want to buy your video recorder at an FOB Yokohama price in Japanese Yen with an unspecified bill to follow later for freight and shipping expenses. Why then assume that your customer in Spain will be happy with a price ex-works Wolverhampton when your German competitor is quoting delivered to his warehouse in Barcelona?

Delivered pricing is more competitive because it is the price the customer usually needs.

Delivered pricing can mean more money for you because it opens up the possibility of earning a margin on the freight and shipping elements.

Delivered pricing means more earnings for Britain because freight and distribution arranged in Britain will tend to benefit British shipping and distribution companies. Delivered pricing can mean better prices, because they can be geared to what the market will bear, which may be higher than you think. How can you compare an ex-works Sheffield price with the price on the market in the USA?
Export costing software can bring delivered pricing within the capability of all companies, regardless of their level of expertise.

Currency pricing

Our main competitors make it easy for customers to buy by quoting in their own currency. Should we expect our customers to take the risk of Sterling fluctuations when software exists allowing us not only to calculate currency prices but to so arrange our currency transactions that we eliminate the exchange risk?

Accurate analysis

We can improve our profitability by costing out our sales and quotations. Clearly, the more accurate our pricing and expenses calculations, the more profitable will be our results.
However, a computerised system allowing us to cost all our transactions will also improve performance by making our marketing decisions more effective. For instance, how do we decide upon priority of allocation of resources between UK and export sales if we cannot properly compare their respective profit contribution? UK and export prices cannot be truly compared unless costings exist bringing the true revenues from those prices onto an equalised basis (eg ex-factory adjusted for sales expenses).
How do we decide in which markets to invest our time and money? If we are selling on free delivered terms to Switzerland, CIF terms to Kuwait and FOB UK port terms to India, how do we decide which market's revenue is yielding the best rate of contribution unless we have a costing system which is sorting out the shipping, freight and sales commission costs in order to give us some common basis of comparison? How often are major international marketing decisions made in British companies in ignorance of such fundamental marketing cost information?

Effective negotiations

A comprehensive export costing system enables us to improve our negotiation performance with both customers and suppliers. Faced with tough price competition from a competitor, how can we really decide whether we can move on price without having an accurate costing available?
If we are negotiating on price, the costing will also pin-point the components of our cost structure which may be open to negotiation with our export 'suppliers' such as shipping lines and our sales agents. For example, a computer costing can show us immediately what would happen if, having to reduce our sales price by 5 per cent, we renegotiated our agent's commission by 2 per cent and persuaded the freight company to reduce the container price by US$400. This sort of information is available virtually instantaneously and in any permutation. This facility is not restricted to the export office.

USING COMPUTER COSTINGS

Computer systems have so changed the possibilities of undertaking export costings for most companies that the potential functions of these costings have now been considerably extended.
Traditionally, the role of export costing has been to check pricing and profitability. This is still valid, but the computerised version has enabled it to be performed much more comprehensively and instantaneously rather than retrospectively. Software has made possible four additional functions:

- Costings as a means of improving profitability rather than of just checking it.
- Costings as an aid to winning business – harnessing financial operations for the benefit of sales and marketing.
- Costings as a negotiating tool.
- Integration of costing systems with quotations production so that prices calculated in the system can be automatically incorporated into quotations or offers.

As the global village becomes more concentrated and buyers become increasingly better informed about sources of supply and competitors' prices, hitting the right price and responding quickly are the major priorities of the exporter. The right computer software can provide the speed and accuracy, coupled with access to the right data, which this situation demands.

Christopher Hensher MIEx (Grad)
First printed 1987, Export Direction