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The Role of Trade Intermediaries in SME Export Growth

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Traditional international trade theory assumes that a manufacturer in one country can directly sell its goods to final consumers located in another country. However, in reality, there exist trade intermediaries that link manufacturers to final consumers in the international market. Trading firms, wholesalers, and retailers are all examples of trade intermediaries.

Although the role of trade intermediaries in trade facilitation has been studied in the international business literature for some time, only recently have trade economists given more attention to the role of trade intermediaries in international trade. How did these trade intermediaries come into existence in trade?

The first reason economists point out is that trade intermediaries exist because they can reduce contracting and matching frictions between buyers and sellers in the international market. Suppliers often do not know the tastes and preferences of buyers located in a foreign region. Also, search costs are high for buyers to find foreign manufacturers who can supply low-cost yet high-quality goods that buyers demand. Admittedly, the role of intermediaries is especially important when buyers and sellers are geographically or culturally distant.

The second role of trade intermediaries is that trade intermediaries verify the quality of suppliers' products on behalf of buyers and mitigate problems of adverse selections. Retailers or wholesalers buy more goods than individual buyers do and have an incentive to invest in inspection technology that allows them to evaluate the quality of suppliers' goods. Individual buyers rely on intermediaries' reputation instead of investigating the quality of each product themselves.

Lastly, Akerman from Stockholm University points out that there exists a high fixed cost of establishing a manufacturer's own distribution network in foreign markets. Akerman argues that the distribution technology that intermediaries posses exhibits economies of scope. As intermediaries deal with a broader variety of goods than manufacturers do, intermediaries are able to spread the fixed cost over the variety spectrum. Manufacturers with moderate productivity may lower the fixed cost of exporting by choosing to indirectly export through intermediaries rather than exporting directly.

All of these points indicate that intermediaries are more important to smaller firms. Large firms are easily identified by buyers and the brand image of their products is already built upon their reputation for good quality. Furthermore, large firms are able to spread the fixed cost of exporting over several goods. On the other hand, products of small and medium enterprises (SMEs) are not identified by buyers in the foreign market, and they have almost no reputation regarding the quality of their products. Also, smaller firms typically have lower productivity than large firms and thus cannot cover the high fixed cost of exporting.

For SMEs that export consumer goods, it has become more important to reach consumers in foreign countries through retailers as retailers expand their chains globally. For instance, Lotte Mart has 107 stores in China, 36 stores in Indonesia, and 6 stores in Vietnam. Lotte Mart is also advocating to "penetrate foreign markets together" and argues that SMEs may benefit from Korean multinational retailers in exporting because the retailers provide assistance with customs procedures and provide knowledge of foreign markets. Furthermore, Lotte Mart provides space in their stores in China exclusively for Korean SME manufactured goods.

There have also been governmental efforts to promote SME export through export intermediaries in Korea. In 1975 the Ministry of Commerce and Industry designated General Trading Companies as government-supported export intermediaries. By the early 1980s, 43.5% of Korean exports were commanded by the designated general trading companies. (Cho 1987)[1]

Now the general trading company system has been replaced with a professional trading firm system. The new professional trading firm system is operated by the Korea International Trade Association (KITA) and the Ministry of Trade, Industry and Energy. The designated professional trading firms purchase goods from SMEs and resell it to foreign markets or assist SMEs' export processes. KITA also cooperates with the Small and Medium Business Administration and the Korea Trade-Investment Promotion Agency (KOTRA) to assist in matching Korean SMEs and foreign buyers by establishing a website to facilitate the search for potential trade partners.

So far the welfare enhancing role of intermediaries in trade and how the principle is applied in the real world was discussed. Welfare, however, cannot be maximized if there is incomplete competition in the market of intermediaries. If powerful intermediaries absorb the tariff cuts in the form of higher markups, consumers may not benefit from lower prices through trade liberalization. The government therefore should monitor closely the intermediaries' anticompetitive behavior and impose appropriate regulations if necessary.

[1] Cho, D.-S., 1984, "The Anatomy of the Korean General Trading Company," Journal of Business Research, 12 241-255.