Adaptive Strategies of Trading Companies

Paul Ellis

Associate Professor
Department of Business Studies, Hong Kong Polytechnic University, Hung Hom, Kowloon, Hong Kong, Tel: (852) 2766 7108; Fax: (852) 2765 0611
Email: buellis@polyu.edu.hk

15 December 2000

Abstract

Past research into the development of trading companies has seldom been able to separate the economic raison d’être of the firm from the political and legislative influence of the home-country government. In contrast with other countries, the evolution of international trade intermediaries in Hong Kong has not been directly influenced by government policy. In the absence of legislative inducements or protection, Hong Kong traders exist purely by their ability to respond to market forces, suggesting that important insights regarding organizational survival can be gleaned from studying their patterns of behavior. In this paper, an evolutionary model is proposed and then evaluated against data collected from trading companies at five different stages of development. Specifically, these firms’ adaptive strategies are assessed in terms of their patterns of diversification along three dimensions: product, geographic, and function. For scholars, the findings may be considered a stepping stone towards the articulation of a truly generic model of trading company evolution, while the value of the study for policy-makers in search of new archetypes lies in the identification of a variety of market-responsive organizational forms.

Key words: trading company, adaptive strategy

1 The author gratefully acknowledges the constructive advice given by Wing-chor Chu of the Hong Kong Trade Development Council, Mimi Yeung of the Hong Kong Exporters’ Association, and two anonymous IBR reviewers. The author also wishes to acknowledge his debt of gratitude to his two research assistants, Wong Hok Ying and Lai Wai Man. The research reported in this paper was funded by the Hong Kong Polytechnic University (Project No.351/384).
Introduction

It is ironic that despite more than three centuries of active participation in international trade, the existence of the ubiquitous trading company is now being threatened by the globalization of markets. Technological developments in communication, transportation, and banking, combined with the ongoing internationalization of manufacturers and customers, have collectively led to the reallocation of many of the traditional distribution functions performed by international trade intermediaries. This has prompted some scholars to label modern trading companies, and in particular large-scale general trading companies (GTCs), as “superfluous”, “inhibiting to the export of anything but the most simple manufactured products”, and generally having “outlived their usefulness” (e.g., Wortzel and Wortzel 1983, pp.74-5). Yet, despite the economic pressures for their elimination, trading companies, for the moment, continue to prosper at the interstices of global markets.

The research aims of this paper concern the identification of those adaptive strategies that ensure the survival of the modern trading company in all its many guises. This goal is somewhat frustrated, however, by the fact that many of the world’s highly diversified trade intermediaries owe their existence to the extra-market intervention of the state (Balabanis and Baker 1993a). One classic example is the symbiotic relationship between the policies of the Meiji Government and the subsequent rise of the Japanese zaibatsu and sogo shosha (Kojima and Ozawa 1984; Sarathy 1985; Yamamura 1976). Short of direct state sponsorship, governments may influence the development of trading companies via inducive or coercive means. Inducements range in degree of intervention from the relaxation of antitrust legislation (e.g., the US Export Trading Companies Act (1982)) to the payment of tax rebates and direct subsidies. In contrast, coercive measures may include the mandatory requirement to satisfy a number of criteria in order to receive GTC status along with the commensurate benefits. For example, in 1975 the Korean government outlined six prerequisites for GTC designation which included maintaining ten or more overseas branch offices and exporting goods worth upwards of $1m to at least ten countries each per year (Cho 1984). A similar scheme was adopted by the Spanish government in 1988. In this case, registered trading companies were required to have annual sales in excess of 1,000m pesetas which included exports of at least 600m pesetas worth of local products (Balabanis and Baker 1993a). Indeed, whether the motives are economic or political, the hand of government is evident throughout the entire history of the trading company, beginning with the monopoly charters assigned by the mercantilist governments of England and Holland, to the original trading houses in the 17th century (Carlos 1992; Carlos and Nicholas 1988).

An exception to this interventionist rule is to be found in the case of the world’s most laissez-faire society, Hong Kong. Unlike that of their Asian, American, and European counterparts, the evolution of Hong Kong trading companies has not been influenced by government policy. In Hong Kong there is no Export Trading Companies Act, no Ministry of International Trade and Industry, and no Five-Year Plan to direct the growth of trade intermediaries. For the vast majority of Hong Kong’s import-export companies, long-term survival is determined purely by market forces. Hong Kong’s system of free enterprise, combined with a local trading environment that is particularly sensitive to external shocks, suggests that important lessons on organizational survival can be gleaned from studying the adaptive behavior of Hong Kong trading companies.

The premise of this paper follows that of Balabanis and Baker (1993a/b) who argue that any understanding of the mechanisms by which trading companies adapt their strategies and structure must begin with the identification of the patterns of diversification exhibited by traders at different stages of development. “The dominant discriminating feature of the GTC concept is their diversity. Thus, diversification theory can provide a more rigorous explanation of the development process of GTCs” (Balabanis and Baker 1993a, p.47). The paper is divided into four sections. In the following section the eclectic literature relating to the trading company concept is briefly reviewed. In particular, Kim’s (1986) life cycle model is introduced and discussed as a basis for understanding GTC development. Next, and by way of providing a backdrop for the analysis of their adaptive strategies, a brief historical outline of the trading environment in which Hong Kong trading companies compete is provided. Third, the methodology used to survey 1,890 traders is described, and finally the study’s main research findings are presented and discussed.
Adaptive Strategies of Trading Companies

Background

Trading companies are characterized by their specialization in market-making intermediation, an activity which may involve brokerage (selling on behalf of another) or reselling (taking title to the goods traded) (Casson 1998). The study of trading companies is arguably more multinational in flavor than any other topic in the field of international business. Trading companies are chauvinistic entities whose missions, organizational structures, and internal cultures reflect the idiosyncratic political and economic conditions of their countries of origin. As a case in point, consider the limited success with which the uniquely Japanese *sogo shosha* concept has been transplanted to other countries (Hvala, Perry, and Boddewyn 1990). Similarly, research into the topic is as context-dependent as the trading company phenomenon itself, with many studies limited to a particular national setting (Table 1). The result is an eclectic body of literature that is characterized by a dearth of widely applicable conceptual schemas and typologies, and which offers limited scope for generalization (Amine 1987).

Much of the existing research on trading companies is highly particularistic in nature, focusing on specific trading issues such as the association between different channel structures and the marketing practices of exporter traders (Bello and Williamson 1985a), or the effect of government policies on the performance of intermediaries (Howard 1995; Kaikati 1984; Williams and Baliga 1983). Some attempts have been made to classify and categorize the subject matter (e.g., Barovick and Anderson 1992; Brasch 1978), but the systematic advance of research has generally been hampered by the lack of consensus on matters of definition and limited attempts at theory-building (Amine 1987; Cho 1987). In particular, much of the research is utilitarian in purpose, providing little more than “snapshots” of the changing roles and functions of trading companies at particular points in time (e.g., Brasch 1978; Kelly and LeCraw 1985; Wichmann 1997). To date there has been little progress in developing a general framework of trading company evolution, and of the dynamic studies which do exist, most reflect the unique characteristics associated with a particular type of trade intermediary and cannot be applied universally (Perry 1990). For example, there are a number of longitudinal case studies which trace the rise of the early European trading houses (Buchan 1994; Sugiyama 1978); several growth models of the distinctive Japanese GTC have been proposed (Cho 1984; Kojima and Ozawa 1984), and at least two scholars have developed frameworks for analyzing the adaptive strategies of US export trading companies (Amine 1987; Perry 1990). Very few growth models exist which are multinational in scope. Balabanis and Baker (1993b) developed a dynamic framework based on those external and internal factors that lead to organizational change. To test their model, they studied the “change intentions” of 29 European trading companies in terms of their geographical expansion, product diversification, and functional and service development. These growth measures reflect the widely-held view that the development of a trading company is evidenced in terms of specific patterns of diversification which are brought about in response to changes in market conditions (Balabanis and Baker 1993a; Cho 1987; Jones 1996). Pioneering conceptual work in this area was done by Kim (1986), who was the first to conceive that the development of the trading company can be conceptualized in terms of a number of distinct and sequential stages that collectively define a GTC life cycle.

The General Trading Company Life Cycle

The term “trading company” encompasses a wide variety of trade intermediaries ranging in size and scope from the small-scale import/export company to the mammoth and prototypical *sogo shosha*. Because the generic concept of the GTC is no longer a strictly Japanese phenomenon, Kim (1986) offers a three-stage explanation for these observed differences in levels of organizational development that is based on economic and institutional factors rather than cultural differences. The Stage I trading company is relevant to an emerging economy characterized by an underdeveloped infrastructure, standardized manufactured goods, and fragmented channels of distribution. In addition, the industrial base may be dominated by small- to medium-sized enterprises (SMEs) requiring the assistance of an intermediary to go abroad. These contextual conditions create a market opportunity for purchasing and sales agents to generate transaction efficiencies by specializing in the trading function and by developing a global market information network. As well as lowering the costs of information acquisition, the trading company may also be able to provide economies of scale for local...
firms in terms of sorting, grading and packaging standardized products, and by routinizing some frequently-repeated transactions.

As the trading company engages in some product and area diversification to spread its risk, it approaches the second stage of development which is characterized by the performance of a number of trade-supporting activities, such as the provision of credit. Trade financing may be warranted if local manufacturers have only limited access to affordable funds and if local lending institutions take the view that local export agents are better placed to evaluate the credit risk of their trading partners (JETRO 1976). Political factors may also play a role at this stage if there is a perceived need to improve the efficiency of trading activities, possibly with a view to replicating the well-publicized success of the *sogo shosha* (e.g., as in the case of the thirteen GTCs created in Korea, a developing country, in 1975), or if there is a desire to create organizations which bridge the gap between local SMEs and export markets (e.g., as in the case of an industrialized country like the US, with its Export Trading Company Act of 1982). As competitive pressures continue to increase, Kim (1986) notes that the Stage II trading company is faced with two choices: (1) it can continue to focus on standardized products (provided the firm has preferential access to low-cost supplies or captive clients), or (2) it can trade up to higher-technology products (which offer good growth prospects and fatter margins).

The trading company enters the third stage of its life cycle when it engages in foreign direct investment to protect its market position from the threat of internationalizing local manufacturers or rising protectionist forces. In addition to the growth in direct exporting among manufacturers, the competitive position of the trading company may be further undermined by the provision of trade-supporting services by banks and government agencies. Although trading remains the principal activity of the firm, its relative importance within the firm decreases to make room for related functions such as shipping, warehousing, and manufacturing. For example, Wortzel and Wortzel (1983) observe that the Japanese *sogo shosha*, which exemplify Stage III GTCs, play a fairly passive role as export marketers taking title to goods primarily to expedite their financial and physical distribution functions. Functional diversification into complementary areas may also be prompted by a lack of local infrastructure or entrepreneurship. Further, there may be a need for the trading company to internalize some trade-related activities to maintain quality control, preserve information asymmetries, or pursue scope economies (Jones 1996). At this advanced stage of development, any government mandates are more likely to be regulatory than strategic in nature.

Although Kim’s (1986) life cycle model implies that, given the right conditions, trading companies ultimately evolve to become analogues of the *sogo shosha*, trading company development is by no means deterministic. Kim concedes that life cycle stages may be by-passed, or they may occur simultaneously rather than sequentially, while some firms may never progress beyond the first or second stages of development. The actual evolutionary paths taken reflect strategic choice which, in turn, is influenced by conditions within the host environment. While the life cycle model provides a general basis for understanding those institutional factors germane to the development of GTCs, it makes no attempt to consider those diversification strategies which may lead the firm away from trading altogether. The implicit assumption is that trading companies never grow to become anything other than highly diversified trading companies. In reality, adaptive parameters are not so narrowly defined.

If the aim is to understand the adaptive strategies or developmental paths exhibited by trading companies over time, any comprehensive explanation must take into account those non-trading diversification alternatives which are available to the growing trading company. For example, and despite the implied suggestion of the life cycle model, a Stage I import/export company is not compelled by environmental forces to “evolve” into a Stage II trading company. Other diversification options exist and perhaps chief among these is the option to vertically integrate into manufacturing (Amine 1987). Support for this assertion comes from Cho’s (1987) study of GTC diversification patterns. Cho was arguably the first to recognize that small traders may diversify in one of two directions: forwards or backwards. Forward integration implies the provision of additional services such as transportation, warehousing and insurance (i.e., progression to the next stage of GTC development), whereas backward integration implies diversification into manufacturing, possibly to counter the threat of opportunism in the channel. Such a move assumes that the trading company is
Adaptive Strategies of Trading Companies

able to leverage its knowledge of foreign markets and distribution channels into a position of competitive parity on the production function. It is plausible that for many small trading firms confronted with the need to diversify, investment into manufacturing may be too costly, prompting either a hybrid arrangement (e.g., contract manufacture) or the further expansion of the firm’s traded product lines and market coverage (i.e., diversification into a Stage II trading company). The manufacturing option identified by Cho (1987) is arguably more suited to Stage II traders who, by virtue of their greater size and experience, are more likely to have access to the capital necessary for such an investment.

Another evolutionary outcome not captured in the life cycle model is observed when the general trading company’s principal activities begin to expand into areas other than trading. Such a change in strategic direction might result from diminished opportunities for trade intermediation as the home economy matures, local manufacturers become more adept at international marketing, and better investment opportunities emerge in brokerage- or service-related industries such as construction, finance, and property development. This has been the experience of the sogo shosha as described by The Economist (1991):

To defend their markets they have gone upstream (into mining and manufacturing) and downstream (into retailing) through equity investments in joint ventures and affiliates. The sogo shosha are changing from pure traders, where high-volume low-margin commission business dominates, to become more financially sophisticated investment holding companies.

The tendency for GTCs to diversify away from trading has been evident from the time of the earliest trading companies, whose investments in foreign production made them forerunners of the modern multinational enterprise (MNE) (Carlos and Nicholas 1988). Whether the trading company is investing in foreign rubber plantations, like the English firm Harrisons & Crosfield (Jones 1996), or car manufacturing, like Korea’s Hyundai Group (Amine 1987), MNE status is achieved when the revenue earned from offshore investments exceeds the income derived purely from trading. Although the switch from GTC to MNE is by no means inevitable (Cho 1987), environmental forces may provide a compelling incentive for both Stage II and III traders to engage in a significant level of foreign direct investment to hedge against the risks associated with trading. Kim (1986) acknowledged as much by defining his Stage III firm as “toward a conglomerate”, but he saw no reason to incorporate this path of diversification in his model of GTC development. Despite the omission of GTCs-turned-MNE conglomerates from Kim’s framework, it is worth noting that the trading history of such firms may have a residual bearing on both the corporate culture and the direction of investment activities. This is particularly evident in the case of Hong Kong, where firms like Jardine Matheson and Swire Pacific are still referred to as hongs despite relegating their trading functions to fairly minor, albeit active, subsidiaries many years ago. Indeed, for many of these former trading houses (e.g., Hutchison), the current core business activity information (in this case telecommunications and port facilities) stems directly from the firm’s early involvement in the international flow of goods. For others such as Jardines, investment decisions in the growing market of the People’s Republic of China (PRC) are overshadowed by the tenor of their past trading relations with the mainland.

In summary, trading companies must adapt to meet the changing export requirements of their host environments. At different points, in time traders may be confronted with one of two choices: either (1) continue to exploit their core competence as market intermediaries and specialize or diversify to improve the efficiency and effectiveness of this service, or (2) functionally diversify to the point where trading is no longer the core business activity of the firm. The first option, played to its logical conclusion, will lead to the development of the diversified GTC, while the second option is more open-ended. However, given the strategic constraints imposed by available skills and resources, it is likely that trading companies that engage in this latter type of diversification will ultimately become either manufacturer-exporters (if some form of backward integration is pursued) or MNEs (if offshore investments come to dominate the business activity of the firm). The main adaptive possibilities open to trading companies are depicted in Figure 1. In contrast with the simple linear progression of the life cycle model (Kim 1986), the figure proposed in this paper allows for six types of adaptation leading to four distinct kinds of organization, each characterized by a particular pattern of diversification and each having a different trading emphasis.
Adaptive Strategies of Trading Companies

In terms of the nature and pace of their organizational development, trading companies, perhaps more than any other international business entity, are influenced by the particular economic and regulatory conditions of their home environments. Consequently, before the empirical relevance of Figure 1 is assessed, it is first necessary to provide some background detail regarding the context in which Hong Kong trading companies have evolved.

**The Hong Kong Trading Environment**

Since the earliest collection of trade statistics, it has been evident that Hong Kong’s trading environment is characterized by its volatility. As the world’s tenth largest trading territory, Hong Kong has not suffered from a protracted recession, but shocks and disruptions have been frequent and disruptive, as evidenced by the magnitude of annual changes in trade growth (Figure 2). In terms of the proportion of trade to gross domestic product, Hong Kong is the world’s second most open economy after Singapore (Ellis 1998b), which means that the local trading environment is especially sensitive to external shocks such as China’s Great Leap Forward (1959), the OPEC price hikes (1973), and the Asian currency crisis (1997). On occasion the nature of an external disruption is such that organizational survival is threatened compelling trading companies to adapt. This can be seen in the case of at least four external jolts (Ellis 1998a):

1. the invasion of Japanese forces in 1941 (which abruptly ended Hong Kong’s entrepôt role, the basis for much of its economic activity at the time),
2. the Japanese surrender in 1945 (which precipitated the swift resumption of the re-export trade with southern China),
3. the Korean War and the resulting United Nations embargo on trade with the PRC in 1951 (which led to the cessation of all entrepôt trade virtually overnight and triggered the industrialization of Hong Kong), and
4. the opening of China’s markets in 1979 (which stimulated the mass migration of Hong Kong industry across the border).

The effect of these environmental disruptions on Hong Kong’s population of trading enterprises can be summarized as follows: the thousands of import/export businesses that had ceased trading after the Japanese invasion in 1941 flourished again in the late-1940s on the back of the colony’s resurgent entrepôt trade. These firms were then obliged in 1951 to replace their mainland Chinese suppliers with local suppliers or go out of business (Woronoff 1980). Subsequent competition for international markets from local manufacturers of clothes, toys, and watches then compelled trading companies to reduce commissions, engage in further product and geographic diversification, and begin investing directly abroad. Many traders simply decided to capitalize on the swelling supply of cheap local labor and go into manufacturing for themselves, with the result that the value of Hong Kong-made exports surpassed re-exports for the first time in the colony’s history in 1959 (Wilson 1990). In the 1980s, economic factors (rising rents and wages) combined with a political thaw in the PRC stimulated the resumption of Hong Kong’s entrepôt role, and once again re-exports replaced domestic exports as the main form of international trade (Ellis 1999). By the mid-1990s, more than one fifth of the local workforce, around half a million people, was employed in import/export enterprises (http://www.tdc.org.hk/).

In the past six decades, environmental disruptions have qualitatively altered the rules of the game for Hong Kong traders on several occasions. The net result is a trading landscape populated by a variety of organizational forms, each of which represents an entrepreneurial response to changing market signals rather than an induced response to political directives. To date very little research has been done on this unique group of 100,000 or so trading companies. Little is known about their patterns of diversification, the nature and direction of their trading activities, or their performance as middlemen in international distribution channels. The methodology used to address these questions is described in the following section.
Methodology

Questionnaire Design

In order to gain some insight into the adaptive strategies enacted by Hong Kong traders, a four-page questionnaire was administered to a sample of 1,890 firms. The questionnaire consisted of several items relating to the personal characteristics of the respondent, 19 descriptive items regarding the extent of diversification and the nature of the firm’s trading activities, and 11 objective and subjective measures of the firm’s performance over the past three years. To ascertain the level of product, area, and functional diversification, operational measures were adapted from the indices used in Cho’s (1987) analysis of the GTC. An area diversification index (ADI) was calculated in two ways: (1) the number of countries actively traded with at the time of data collection, and (2) the proportion of sales income earned outside of Hong Kong and the PRC. Functional diversification (FDI) was ascertained by identifying the number of support services offered as selected from a list of 26 alternatives. Product diversification (PDI) proved to be the most troublesome variable to measure. Following Cho’s (1987) procedure, respondents were initially asked to identify the number of two-digit Standard International Trade Classification (SITC) categories in their product ranges and then provide information regarding the proportion of sales earned in each category. However, several iterative pretests of the questionnaire among a group of six traders revealed that this item was hopelessly intractable and difficult for respondents to answer. In the end, a list of 24 product categories was provided that approximated the two-digit level of aggregation with a question asking the respondent to indicate the percentage of the firm’s sales, if any, earned from each category. An index was then calculated by multiplying the number of product lines by the proportion of sales generated outside the principle product. For example, if a respondent checked three product categories indicating relative income shares of 80, 15, and 5 per cent, then the relevant PDI is 0.60 (or three times 0.20).

Sample Selection

The sample was defined as the population of indigenous trading companies listed in two recently published directories (Registry of Hong Kong Traders 1997; Members’ Directory 1997). The questionnaire was mailed twice and then faxed personally to the most senior executive identified in the directories. Although the use of self-report data is not without its limitations (see for example, Ganster, Hennessy and Luthans, 1993), the nature of the inquiry justified the reliance on subjective measures. First, it can be assumed that traders’ perceptions of their environment will affect their strategy-making, irrespective of whether those perceptions are valid or not (Anderson and Paine 1975; Miller 1988). Traders who are not "clued in" to their multiple operating environments will not make the appropriate adjustments when those environments change. Thus, trader experience or survival should be correlated with a track record of accurate "sense-making" of environmental change. Second, past research has indicated that relying on a knowledgeable "informant's perceptions of an organisation's strategic orientation is a valid approach to measuring strategy" (Shortell and Zajac 1990:829). Finally, subjective performance assessments are suitable in situations where "(1) accurate objective measures are unavailable and (2) the alternative is to remove the consideration of performance from the research design" (Dess and Robinson 1984:271). Traders are universally secretive by nature and are indeed particularly so when it comes to measuring their performance (see for example, Guex 1998). This is no less true in Hong Kong, where owner-operators are the sole gatekeepers to such information, and the vast majority (more than 95 per cent) of firms are privately-held entities.

At the close of data collection, 47 questionnaires had been returned uncompleted because the respondent did not consider their firm to be significantly involved in the trading (i.e., import/export) business. A further 35 questionnaires were discarded from the database because the respondents reported that their headquarters were located outside of Hong Kong. The large number of ineligible responses indicated that the criteria for inclusion in the published directories were somewhat broader than the sampling frame used in this study. In addition to the ineligibles, 300 questionnaires were returned undelivered, reflecting both the attrition rate of the recent Asian economic crisis and the footloose nature of small import/export companies. In all, 211 useable questionnaires were received.

The effective response rate was calculated based on the formula advocated by the Council of American Survey Research Organizations (CASRO) for surveys with single-stage sampling and an
eligibility requirement (Churchill 1995; Burns and Bush 2000). The critical variable in determining
the response rate in a study of this nature is estimating the number of eligible firms receiving the
questionnaire. There were two methods for calculating this figure. First, of those who made the effort
to return the questionnaire, only 72 per cent were eligible for inclusion in the study (i.e., they were
significantly involved in trading and had their head office in Hong Kong). Second, follow-up phone
calls made to a random subsample of 150 listed traders revealed that 24 per cent of the surveyed firms
were ineligible for inclusion for one of the two reasons mentioned. Using the more conservative
estimate of 24 per cent indicates that 454 firms receiving the questionnaire did not meet the sampling
requirements of the study. The resulting response rate of 35.0 per cent was considered satisfactory
given the performance of similar surveys done in Hong Kong where response rates can be less than
ten per cent (e.g., Chan and Ellis 1998). Nevertheless, to test for possible non-response bias,
descriptive data collected during the follow-up phone-calls were compared with information provided
by respondents. No significant differences between the two samples were found in terms of the
number of years trading ($t=0.31, p=0.75$), the number of local ($t=1.18, p=0.24$), mainland Chinese
($t=1.02, p=0.31$), and foreign employees ($t=1.07, p=0.28$), and the proportion of products sourced from
Hong Kong ($t=0.77, p=0.44$), China ($t=1.36, p=0.17$), or elsewhere ($t=-1.65, p=0.10$), suggesting that non-
response was not a source of bias in this study.

Analysis and Findings

Table 2 provides a summary of the general descriptive characteristics of the trading companies and
the respondents. More than 90 per cent of the firms in the sample reported more than five years’
trading activity. Similarly, more than four-fifths of the respondents themselves have been actively
involved in trading for more than five years, indicating their experience and suitability for completing
the questionnaire. A wide range of industries is represented by the traders, as indicated by the
assortment of product lines carried (Table 3). Chief among these are exports of clothing and electrical
goods, two product categories which have been the mainstay of Hong Kong’s economic development.

Classifying the Traders

As a starting point for the analysis, respondents were classified according to the five trader-types
identified in Figure 1. Although all the firms in the survey were defined as trading companies by
virtue of their inclusion in a commercially-produced directory of traders, to qualify as a trading
company for the purposes of this study, the products traded had to come primarily from sources
external to the firm. Consequently, any firm manufacturing 50 per cent or more of their traded
products was deemed to be an exporter, and any exporter with significant foreign direct investment,
as proxied by the employment of overseas workers (outside Hong Kong and China), was labeled an
MNE. This classification choice led to the identification of 35 manufacturer-exporters and 16 MNEs
in the sample. The surrogate indicator of foreign employees was also used to determine those traders
with significant foreign investments, resulting in the identification of 28 Stage III trading companies.
The remaining traders were split into two groups by looking at the specific trade-supporting services
used to calculate the degree of functional diversification. According to Kim (1986), Stage II traders
can be distinguished from their Stage I counterparts by their provision of financial resources to
trading partners. In the survey, 41 respondents indicated that they offer trade financing to clients, thus
deeming themselves to be Stage II traders and leaving 91 Stage I traders.

Having identified the five types of trading company, ANOVAs were conducted to ascertain
differences among the main descriptive variables (Table 4). The findings generally support the view
that, as trading companies evolve, they tend to exhibit increasing levels of product, geographic and
functional diversification (Balabanis and Baker 1993a). As expected, Stage I traders were the
youngest trading companies in the sample and reported lower levels of diversification on all measures
except the number of foreign markets, which was similar across all three stages of development. As a
group, the traders, and particularly the more experienced traders, evidenced higher levels of product
diversification than the exporters (i.e., the manufacturers and MNEs), perhaps indicating their greater
need to safeguard against the threat of opportunism. For example, manufacturer-exporters run little
risk of being supplanted by suppliers if they are responsible for their own production. In contrast,
Adaptive Strategies of Trading Companies

traders need to carry a wider variety of product lines to minimize their dependence on any one supplier. Interestingly, the exporters compensate for their relatively low levels of product diversification by leveraging their product expertise across a larger number of foreign markets. The traders in the sample, irrespective of their stage of development, were on average involved in fewer than seven foreign markets. In contrast, the manufacturer-exporters were active in almost ten foreign markets, while the MNEs surveyed were active in twice as many markets as the traders, as befits their multinational designation.

INSERT TABLE 4 ABOUT HERE

Other significant differences observed include firm size, with the advanced levels of development being associated with an increase in both the scale and dispersion of operations. In general, Stage II traders are significantly larger and employ more workers in China than Stage I traders, while Stage III traders have the largest and, by definition, most regionally-dispersed workforce of all trading groups. Unsurprisingly, the largest companies in the sample are those responsible for their own production (manufacturer-exporters and MNEs). This group of firms has evidently capitalized on the supply of cheap labor in the mainland, as indicated by their very large numbers of PRC employees.

Respondents were asked to estimate the proportion of total income derived from trading activities. Again consistent with the literature (Kim 1986), the findings show that as a trader becomes more diversified and develops into a GTC (i.e., Stage II → Stage III), the relative importance of trading activities within the firm’s overall service offering diminishes (Table 4). Nevertheless, trading remains the dominant activity of the firm accounting for more than four-fifths of the income earned by all trading groups. The findings also reveal that the two exporter groups have significantly lower trading shares than the trading companies (75% for manufacturer-exporters and 53% for the MNEs), further indicating that the classification schemas used were sufficiently discriminating.

The Nature and Direction of Trading Activities

Hong Kong’s entrepôt role as the preeminent service provider to Guangdong province is clearly evident in the pattern of trade reported by respondent firms (Table 5). Although respondents were able to select from six distinct types of trading activity (imports, re-exports, exports, transshipments, third-country trade, and wholesale/retail trade), Stage I and II traders were generally biased towards imports/re-exports, with China being the dominant supplier for the latter group. Stage I traders were also heavily involved in local distribution (wholesale and retail trade), more so in fact than any other group in the sample. At the other end of the scale, the Stage III traders reported the lowest levels of domestic trade (6%) and the highest levels of third-country trade (24%) where goods are shipped direct to the market without stopping in Hong Kong. This finding is significant as functional expansion into third-country trade is a hallmark of a mature trading company and is seldom undertaken by novice traders (Balabanis and Baker 1993b). With their regionally-dispersed workforces, Stage III traders source nearly three quarters of their products from outside of Hong Kong and China. Of the two self-manufacturing groups, the MNEs also recorded high levels of offshore trade (15%) in comparison with the more localized manufacturer-exporters (1%). Consistent with their high levels of employment in China, the manufacturer-exporters had by far the highest levels of re-exports in the sample.

Finally, there was a readily-observable association between the level of development of the trading company and the overall size and regional dispersion of their supplier networks. Mature Stage III traders were the least likely group to source from local suppliers and were reliant on foreign factories for 70 per cent of their business. As expected, MNEs also had larger and more dispersed networks of suppliers than manufacturer-exporters. This finding suggests that the social capital inherent within a trader’s list of contacts takes time to develop. Indeed, organizational development may itself be constrained by the boundary horizon of the trading network (Balabanis and Baker 1993a; Rauch 1996).

INSERT TABLE 5 ABOUT HERE
Performance Comparisons

Finally, the five groups of firms were compared in terms of their trading margins and operating performance (Table 6). MANOVA was used to assess differences across three composite performance measures; sales growth and profitability over each of the last three years, and the respondents’ own subjective appraisal of four performance measures. Although the Stage III traders and MNEs generally enjoyed superior performance across the board, none of the observed differences are significant at the \( p < .05 \) level. The lack of strong, clear differences in performance is interesting given the disparity on measures of diversification, firm size, and trading networks, and suggests that fierce competition exists within each organizational category.

Conclusions

Few trading companies have been as exposed to changing market conditions as those trade intermediaries that are based in Hong Kong. Organizational survival in such an environment requires timely adaptation and an entrepreneurial talent for anticipating market trends. In this study the analytical focus has been on the adaptive strategies of trading companies as evidenced by patterns of diversification along three dimensions. Expanding on Kim’s (1986) original framework, alternative paths of organizational development were defined broadly to take into account those strategic moves which may lead to a de-emphasis on trading activities within the firm. This led to the \textit{a priori} identification of five distinct trading entities which, based on the preceding analysis, may now be summarized, with reference to the Hong Kong situation, as follows:

- **Stage I trading companies** are product specialists offering the fewest support services and trading in a very narrow range of products. They are primarily engaged in importing foreign-made products which they distribute locally and within China. They are the smallest and most trade-dependent of the trading companies.

- **Stage II trading companies** are generalist traders involved in a wider range of products and markets than Stage I companies. They also offer a considerably fuller range of trade-supporting services than their Stage I counterparts. Stage II traders tend to be involved in significant levels of contract manufacturing, accounting for one-third of their traded goods – more than any other trading company – and they employ the largest number of workers in China. Whereas Stage I traders bring foreign products into Hong Kong and China, Stage II traders tend to operate in the reverse direction, as indicated by their high levels of re-exports of Chinese-made products.

- **Stage III trading companies** are distinguished by their foreign direct investment and their regionally-dispersed workforces. Of the three types of pure trading companies, Stage III firms are the largest in size, have the most extensive trading networks, are the least active in domestic trade and are the least trade-dependent overall, with 15 per cent of their income coming from non-trading activities. Consistent with their high levels of foreign investment, these GTCs are heavily involved in third-country trade, which surpasses the combined value of their re-exports and domestic exports.

- **Manufacturer-exporters** are on average more than five times larger than the GTCs due to their distinguishing emphasis on production. These firms assume the manufacturing risk for nearly 90 per cent of the goods they trade, and most of their production takes place in China with finished goods being re-exported via Hong Kong. The market-expansion strategy of these manufacturer-exporters is based on leveraging their relatively narrow range of products across a large number of markets. Hence these firms tend to be highly-internationalized in terms of their sources of revenue.

- **MNE-traders** are distinct from the other trader-types in the sample in that they derive almost half of their income from activities other than trading. Moreover, their scope of operations is truly multinational and they operate in the greatest number of markets. Like the manufacturer-exporters, MNE-traders assume responsibility for most of their own production although they are generally less reliant on Chinese sources of supply. Similarly, with their regionally-dispersed workforces, these large firms are more akin to the GTCs in their reliance on third-country trade.

---

\begin{table}
\centering
\caption{Performance Comparisons}
\begin{tabular}{|c|c|c|c|}
\hline
Performance Measure & Stage I & Stage II & Stage III \\
\hline
Sales Growth & 12.3 & 15.6 & 20.2 \\
Profitability & 0.35 & 0.42 & 0.48 \\
Subjective Appraisal & 7 & 8.5 & 9 \\
\hline
\end{tabular}
\end{table}

---
Trading companies are highly entrepreneurial organisational entities that are alert to new and emerging opportunities and are resourceful in setting up trading systems to exploit these opportunities (Jones 1998). It is surprising therefore, that trading companies to date have received relatively little attention from scholars other than historians. Existing research within the international business domain is largely nationalistic in scope, and this is particularly true of the few available developmental studies. Investigations of trading company evolution based on samples drawn from particular settings such as Japan, where local political factors are formative, will have limited utility elsewhere (Perry 1990). This study, conducted in a laissez-faire environment, represents a first step to remedy this situation. The value of this study lies in the identification of five distinct clusters of trading companies, each of which represents a qualitatively different entrepreneurial response to changing market signals uninterrupted by political noise. Although the research setting is unique, and patterns of adaptation are fundamentally influenced by local economic and institutional conditions, the actual diversification paths are generic in nature. The result is an empirically verifiable model of trading company evolution that offers potentially more utility than Kim’s (1986) life cycle framework.

**Implications for Policy Makers and Practitioners**

Trading companies come in many shapes and sizes. Ignorance of this fact is perhaps one of the main reasons why GTC-promoting policy has generally failed to live up to expectations. Policy prescriptions may be unduly restrictive in defining the scope of GTC activity. In their pursuit for tax-benefits and other incentives accorded to those trading companies which "fit the bill", traders may engage in patterns of diversification which have limited economic justification. In this sense, political inducements may actually impede the normal function and development of trading companies with consequent adverse social costs. As a case in point, Dicle and Dicle (1992) note that the attractiveness of government incentives may lead to abuses, such as the falsification of documents or the reporting of fictitious exports. Highly-publicized success stories can also be misleading. For example, the export performance of Korea’s state-supported GTCs represents the billing of export sales recorded by existing trading companies which simply took advantage of the incentives provided by the government to alter their organizational form (Balabanis and Baker 1993b; Wortzel and Wortzel 1983). Similarly, in America it is likely that many of the current multinational trading companies would have been formed irrespective of the passing of the Export Trading Companies Act (Amine, Cavusgil and Weinstein 1986). Finally, and most telling, scholars investigating export reform have suggested that some trading companies would disappear altogether if political support was removed (Dicle and Dicle 1992). All of this suggests that despite the best efforts of governments, the direction of development of trading companies, and the emergence of new and efficient forms of organization, is still largely dictated by market forces (Balabanis and Baker 1993b). In view of this, implications for legislators are largely limited to policies encouraging competition and the free flow of market information. These, in turn, will provide all the stimulus needed for trading companies to diversify to ever-increasing levels of maturity and market responsiveness. Where more "proactive" levels of support are desired, policy-makers should craft incentive schemes in such a way to reflect the different adaptive possibilities open to indigenous firms. The chief value of this study for policymakers, therefore, is in the identification of six generic diversification paths. Additional routes of development may be identified on a case-by-case basis, reflecting the needs of the host country (e.g., for basic commodities, infrastructure, technology transfer, improvements in local retailing, etc.).

Traders have been characterized as opportunists, more interested in short-term profits than in long-term success (Balabanis and Baker 1993a). This largely reflects the inevitably terminal nature of trading relationships and the ever-present threat of opportunism from each end of the channel. Managerial lessons that can be drawn from this study are twofold. First, the primary mechanism for minimizing the risk of elimination evidenced by the traders in this study is product diversification. The traders as a group reported significantly higher PDI levels than the exporters who, in turn, were active in more foreign markets. In other words, traders survive by leveraging their market knowledge across many products, whereas exporters tend to do the opposite. Second, while product diversification may forestall elimination in the short to medium term, organizational survival is ultimately a function of adaptation, which implies the effective matching of organizational capabilities to new and emerging market opportunities. For the traders in this study, the unique
capabilities associated with longevity seem to be increasingly dispersed supplier networks and the management of third-country or triangular trade. However, successful adaptation may also come from diversifying out of trading altogether.

**Limitations and Directions for Further Research**

The value of this study in proposing a dynamic model of trading company evolution must be gauged in light of the cross-sectional nature of the investigation. Clearly the aims here were biased towards theory-building, and longitudinal research is required to investigate whether actual trading company development follows the evolutionary paths identified. Historical case studies tracing the development of GTCs over time will also be useful in this regard (Ellis 1998a). Further work is also needed to refine measures of trading company development. One of the difficulties encountered in this study was the measurement of product diversification. SITC-based measures will be useful when the researcher has access to archival data (see for example, Cho 1987), but for survey research, a simpler alternative is needed. Even in personal interviews SITC-measures have shortcomings, as revealed by the pretesting done here, for traders are often not readily familiar with all the SITC-codes represented in their product assortments. The approach adopted in this study, while pragmatic, is far from ideal, as the number of product categories selected to approximate the two-digit SITC level of aggregation is ultimately arbitrary.

Finally, a significant weakness endemic in trading company research is a lack of consensus regarding basic matters of trader definition (Amine 1987). Until Casson's (1998) recent attempt at crafting a generic classification, few scholars had bothered to define their subjects in terms relevant beyond their particular national and industrial settings. Clearly there are important differences between Cho's (1984) Korean GTCs, Bello and Williamson's (1985b) American export trading companies, Yamazaki's (1987) Japanese *sogo shosha*, and Mattsson's (1990) smaller European traders. Such differences both belie the creative adaptability of trading companies and hinder the systematic advance of our understanding of the adaptive process. In this study, traders were conveniently distinguished from exporters by their sources of supply, whether largely internal or external to the firm. However, this approach is not without its limitations, as care must then be exercised to discriminate international traders from domestic middlemen (e.g., wholesalers and retailers). (Often both types of trader are listed together in published directories.) The term "trader" means many things to many people. Further definitional clarity at the conceptual and operational levels is fundamental to the systematic advance of research in the area.

**References**


Adaptive Strategies of Trading Companies


Economist, The: The Giants that Refuse to Die. 1 June 1991, p.84.


Adaptive Strategies of Trading Companies


Registry of Hong Kong Traders. Dun and Bradstreet: North Point, HK. 1997.


Wilson, Dick: Hong Kong! Hong Kong!, London: Unwin Hyman (1990).


Adaptive Strategies of Trading Companies


Adaptive Strategies of Trading Companies

TABLE 1: The National Roots of Trading Company—Research

<table>
<thead>
<tr>
<th>Country</th>
<th>Research</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>Pinto 1983</td>
</tr>
<tr>
<td>Canada</td>
<td>Castaldi, De Noble, and Kantor 1992; Kelly and Lecraw 1985</td>
</tr>
<tr>
<td>Korea</td>
<td>Cho 1984; Wortzel and Wortzel 1983; Lee 1987</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Sluyterman 1998</td>
</tr>
<tr>
<td>Sweden</td>
<td>de Geer 1998; Mattsson 1990</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Guex 1998</td>
</tr>
<tr>
<td>Turkey</td>
<td>Dicle and Dicle 1992</td>
</tr>
<tr>
<td>UK</td>
<td>Buchan 1994; Carlos 1992; Jones 1987; Jones 1996; Sugiyama 1987</td>
</tr>
</tbody>
</table>

TABLE 2: Sample Characteristics

<table>
<thead>
<tr>
<th>Firm Characteristics</th>
<th></th>
<th>Respondent Characteristics</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>n</td>
<td>valid per cent</td>
<td>Gender</td>
</tr>
<tr>
<td>Ownership</td>
<td></td>
<td></td>
<td>male</td>
</tr>
<tr>
<td>public</td>
<td>13</td>
<td>6.2</td>
<td>female</td>
</tr>
<tr>
<td>private</td>
<td>197</td>
<td>93.8</td>
<td></td>
</tr>
<tr>
<td>missing</td>
<td>1</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>211</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Total Sales (HK$m)</td>
<td></td>
<td></td>
<td>Ethnic Background</td>
</tr>
<tr>
<td>less than 5</td>
<td>13</td>
<td>6.3</td>
<td>Chinese</td>
</tr>
<tr>
<td>6-10</td>
<td>19</td>
<td>9.2</td>
<td>European</td>
</tr>
<tr>
<td>11-50</td>
<td>60</td>
<td>29.0</td>
<td>Japanese</td>
</tr>
<tr>
<td>51-100</td>
<td>27</td>
<td>13.0</td>
<td>other</td>
</tr>
<tr>
<td>101-500</td>
<td>61</td>
<td>29.4</td>
<td>missing</td>
</tr>
<tr>
<td>more than 500</td>
<td>27</td>
<td>13.0</td>
<td></td>
</tr>
<tr>
<td>missing</td>
<td>4</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>211</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Years Trading</td>
<td></td>
<td></td>
<td>Trading Experience</td>
</tr>
<tr>
<td>less than 5 years</td>
<td>21</td>
<td>10.0</td>
<td>less than 5 years</td>
</tr>
<tr>
<td>5-10</td>
<td>58</td>
<td>27.6</td>
<td>5-10</td>
</tr>
<tr>
<td>11-20</td>
<td>75</td>
<td>35.7</td>
<td>11-15</td>
</tr>
<tr>
<td>more than 20 years</td>
<td>55</td>
<td>26.2</td>
<td>16-20</td>
</tr>
<tr>
<td>missing</td>
<td>2</td>
<td>-</td>
<td>21-25</td>
</tr>
<tr>
<td></td>
<td>211</td>
<td>100.0</td>
<td>more than 25 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>missing</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### TABLE 3: Industries Represented

<table>
<thead>
<tr>
<th>Industry</th>
<th>n</th>
<th>%</th>
<th>Industry</th>
<th>n</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>food</td>
<td>9</td>
<td>4.1</td>
<td>paper/stationery</td>
<td>14</td>
<td>6.5</td>
</tr>
<tr>
<td>beverages</td>
<td>7</td>
<td>3.2</td>
<td>clothing</td>
<td>58</td>
<td>26.7</td>
</tr>
<tr>
<td>plastic products</td>
<td>27</td>
<td>12.4</td>
<td>textiles/yarns</td>
<td>29</td>
<td>13.4</td>
</tr>
<tr>
<td>chemical goods</td>
<td>18</td>
<td>8.3</td>
<td>footwear</td>
<td>6</td>
<td>2.8</td>
</tr>
<tr>
<td>drug specialists</td>
<td>3</td>
<td>1.4</td>
<td>leather goods</td>
<td>6</td>
<td>2.8</td>
</tr>
<tr>
<td>metals/minerals</td>
<td>14</td>
<td>6.5</td>
<td>travel goods</td>
<td>10</td>
<td>4.6</td>
</tr>
<tr>
<td>petroleum products</td>
<td>3</td>
<td>1.4</td>
<td>furniture</td>
<td>11</td>
<td>5.1</td>
</tr>
<tr>
<td>construction materials</td>
<td>11</td>
<td>5.1</td>
<td>electrical goods</td>
<td>55</td>
<td>25.3</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>others</td>
<td>49</td>
<td>22.8</td>
</tr>
</tbody>
</table>

* Number of firms trading each product.

### TABLE 4: Descriptive Characteristics

<table>
<thead>
<tr>
<th></th>
<th>Trading Companies</th>
<th>Exporters</th>
<th>F-ratio</th>
<th>p&lt;</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Stage I</td>
<td>Stage II</td>
<td>Stage III</td>
<td>Mfr-exporter</td>
</tr>
<tr>
<td><strong>Diversification</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PDI</td>
<td>0.42</td>
<td>0.79</td>
<td>0.61</td>
<td>0.18</td>
</tr>
<tr>
<td>ADI'</td>
<td>36.80</td>
<td>57.04</td>
<td>47.61</td>
<td>88.64</td>
</tr>
<tr>
<td>FDI</td>
<td>5.63</td>
<td>10.24</td>
<td>8.36</td>
<td>9.37</td>
</tr>
<tr>
<td><strong>Years trading</strong></td>
<td>14.43</td>
<td>20.77</td>
<td>22.89</td>
<td>13.77</td>
</tr>
<tr>
<td><strong>Firm Size</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>HK employees</td>
<td>27.48</td>
<td>32.88</td>
<td>43.04</td>
<td>29.60</td>
</tr>
<tr>
<td>PRC employees</td>
<td>43.09</td>
<td>74.38</td>
<td>66.96</td>
<td>757.71</td>
</tr>
<tr>
<td>other employees</td>
<td>0.00</td>
<td>0.00</td>
<td>45.57</td>
<td>0.00</td>
</tr>
<tr>
<td>total employees</td>
<td>70.89</td>
<td>105.85</td>
<td>154.71</td>
<td>786.74</td>
</tr>
<tr>
<td><strong>Relative share of trading activity</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>88.46</td>
<td>89.28</td>
<td>84.36</td>
<td>74.58</td>
</tr>
<tr>
<td><strong>Trader Type</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>merchant</td>
<td>73.62</td>
<td>71.71</td>
<td>66.75</td>
<td>81.03</td>
</tr>
<tr>
<td>commission</td>
<td>27.01</td>
<td>28.29</td>
<td>30.79</td>
<td>13.09</td>
</tr>
<tr>
<td><strong>Manufactured By</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>us</td>
<td>4.75</td>
<td>3.41</td>
<td>3.86</td>
<td>89.00</td>
</tr>
<tr>
<td>under contract</td>
<td>21.49</td>
<td>36.83</td>
<td>34.96</td>
<td>7.86</td>
</tr>
<tr>
<td>others</td>
<td>73.87</td>
<td>59.76</td>
<td>57.61</td>
<td>3.14</td>
</tr>
</tbody>
</table>

* Variable used as classification criterion.
* Number of countries actively trading with at present.
* A MANOVA was conducted based on all four size measures; Hotellings F ratio = 9.958, p<.000.
* Relative share of total trading activity. Numbers do not add up to 100 due to rounding.
### TABLE 5: Nature and Direction of Trading Activities

<table>
<thead>
<tr>
<th>Trade Type</th>
<th>Stage I</th>
<th>Stage II</th>
<th>Stage III</th>
<th>Mfr-exporter</th>
<th>MNE-trader</th>
<th>F-ratio</th>
<th>p&lt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>imports</td>
<td>28.94</td>
<td>28.88</td>
<td>40.19</td>
<td>2.58</td>
<td>21.56</td>
<td>6.566</td>
<td>.000</td>
</tr>
<tr>
<td>re-exports</td>
<td>29.77</td>
<td>44.10</td>
<td>17.96</td>
<td>61.97</td>
<td>19.60</td>
<td>8.614</td>
<td>.000</td>
</tr>
<tr>
<td>exports</td>
<td>9.82</td>
<td>14.54</td>
<td>4.37</td>
<td>21.47</td>
<td>14.80</td>
<td>2.372</td>
<td>.054</td>
</tr>
<tr>
<td>transhipments</td>
<td>3.92</td>
<td>6.25</td>
<td>4.46</td>
<td>7.73</td>
<td>14.80</td>
<td>1.079</td>
<td>NS</td>
</tr>
<tr>
<td>third-country</td>
<td>4.06</td>
<td>2.88</td>
<td>24.31</td>
<td>1.21</td>
<td>15.13</td>
<td>6.974</td>
<td>.000</td>
</tr>
<tr>
<td>Number of firms</td>
<td>91</td>
<td>41</td>
<td>28</td>
<td>35</td>
<td>16</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### TABLE 6: Performance Comparisons

| | Stage I | Stage II | Stage III | Mfr-exporter | MNE-trader | Multivariate F-ratio | Univariate F-ratio | p< |
| | | | | | | | | |
| Number of firms | 91 | 41 | 28 | 35 | 16 | | | |
| last year | 3.52 | 3.28 | 3.67 | 3.61 | 4.06 | 4.00 | 4.22 | 4.16 | 4.25 | 0.401 | NS | |
| 2 years ago | 3.89 | 3.59 | 4.52 | 4.22 | 4.75 | 4.30 | 4.75 | 4.16 | 4.25 | 3.747 | NS | |
| 3 years ago | 4.11 | 3.63 | 4.63 | 4.16 | 4.25 | 4.30 | 4.75 | 4.16 | 4.25 | 3.747 | NS | |
| Profitability | 0.591 | NS | |
| last year | 2.39 | 2.51 | 2.74 | 2.38 | 2.62 | 2.38 | 2.62 | 2.38 | 2.62 | 1.029 | NS | |
| 2 years ago | 2.62 | 2.54 | 2.91 | 2.58 | 2.85 | 2.58 | 2.85 | 2.58 | 2.85 | 1.029 | NS | |
| 3 years ago | 2.67 | 2.53 | 2.87 | 2.58 | 2.82 | 2.58 | 2.82 | 2.58 | 2.82 | 1.029 | NS | |
| Satisfaction with | 0.976 | NS | |
| sales growth | 2.73 | 2.75 | 2.65 | 2.74 | 3.00 | 2.74 | 3.00 | 2.74 | 3.00 | 0.214 | NS | |
| operating profits | 2.53 | 2.80 | 2.65 | 2.63 | 2.81 | 2.63 | 2.81 | 2.63 | 2.81 | 0.486 | NS | |
| profit/sales ratio | 2.52 | 2.75 | 2.88 | 2.53 | 3.12 | 2.53 | 3.12 | 2.53 | 3.12 | 1.547 | NS | |
| ROI | 2.41 | 2.37 | 2.88 | 2.44 | 2.94 | 2.44 | 2.94 | 2.44 | 2.94 | 1.896 | NS | |

*Relative share of total trading activity. Numbers do not add up to 100 due to missing values and/or rounding.

*Proportion of total.

*Sales growth over each of the last three years as measured on a 7-point scale ranging from “decline” to “20+%”.

*Profitability over each of the last three years as measured on a 3-point scale: loss, break-even, profit.

*Subjective assessments of last year’s performance measured on a 5-point scale ranging from 1 (highly dissatisfied) to 5 (highly satisfied).
FIGURE 1: Evolutionary Paths Open to the Trading Company

Stage I
Trading Company

vertical integration
vertical integration
product/area diversification

Manufacturer-Exporter

Stage II
Trading Company

vertical integration
strategic investment into non-trading areas
functional diversification

MNE-Trader

Stage III
Trading Company

strategic investment into non-trading areas