

## Notes On Selling To Western Firms

### *It is important to bear in mind these observations*

**No firm is waiting for new suppliers.** Purchasers look for long term relationships with suppliers, they assiduously help suppliers to perform better. They help with quality assurance, advice on materials perhaps, cooperate in delivery arrangements, require suppliers to demonstrate how they will continue to supply if things go wrong. Firms are inundated daily with offers of further services. The bigger firms, who are the only sources of large orders for repeat business of particular components, have large buying teams with specialists buying particular commodities. Normally one has to make appointments well in advance to see a specialist buyer in a firm like Ford UK. A new salesman will need to be well introduced, recommendations from other satisfied customers help. The defence industries of Russia might be a sufficient novelty to gain an interview. However long experience both of soviet military and civilian equipment does not inspire confidence. Recent western experience of working in the fSU and eastern Europe, especially in the factories that have been opened to them, has diminished that confidence still further. Consequently the interview will have to be carefully handled. Claims of lower prices on their own are unlikely to be prove attractive. The buyer's job is to buy in the best market anywhere in the world and he does so with skill and experience. The best that can be hoped for is to ask for a trial order for something specific and suggest that they be treated as another source of supply. No newcomer can hope for more.

Very few Russian factories are organised to supply large quantities at competitive prices of elementary components such as ordinary mild steel nuts and bolts. In every advanced industrial country (AIC) such things are supplied by a very few firms who specialise in that trade. They are equipped with the latest automatic machinery, with very high productivity and therefore low unit cost of processing. Therefore labour costs are not significant, the cost of material predominates and the purchases are in such large volumes that the buyer can enforce a significant discount on offered prices. The culture of the factory is continuously seeking for cost reduction of every element and of improvement in performance such as delivery and cost. Furthermore they are required to deliver to customers that use large quantities on a daily basis if not even more frequently. Reliability of delivery and of consistent qualities in products are paramount. It is very rare for harmonious relations between supplier and customer to be broken by, for example, a rare disturbance to the trade. This is especially true of Japan and increasingly of the countries of the Pacific Rim which share the Confucian social and work ethic.

Consequently one should not place too many hopes on such large volume manufacturing orders. Large customers expect to be visited, they are very unlikely to make initial visits especially abroad to inspect potential new suppliers. They almost certainly have their local representatives in important territories where they may be selling as well as purchasing. Their attendance at fairs, exhibitions and conferences with the intention of buying is very unlikely.

Having set out the constraints facing Russian factories in securing large volume orders for simple components, we should now turn to the opportunities for specialist work which will be placed in relatively modest batches and therefore suit the organisation of the Russian defence factories in particular. These might

emanate from specialist firms making internal combustion or diesel engines for duties other than for automotive vehicles made in large numbers. Their annual output might be of the order of 100,000 units. Such firms typically place orders for castings, special bolts in mechanical products; electrical gear such as starter motors and control panels. Their requirements are for high quality products, with tight specifications as to materials, heat treatment, finish and accuracy and close adherence to specification as well as for production equipment and laboratory instrumentation. We have observed Russian general directors who take a casual look at foreign components and immediately assert that they can do that too. Such statements merely irritate and reduce confidence in the ability to understand what is involved. A very close study and understanding of the specification is needed before saying anything except "we will study this". Even apparently simple and straightforward items are more subtle than meet the eye and contain hidden pitfalls. It will be essential for the centre and its associates to equip themselves with national standards for materials, performance and safety standards for components and assemblies as well as of special requirements in specific areas of application such as hospitals and special laboratories. These are over and above the national standards which may provide merely a minimum standard.

**Russian industry has to face frankly their difficulties in meeting quality targets consistently and economically.** Apart from some specific materials those generally supplied to them are not only restricted in the range of available specifications but are also variable in properties. Processing is often insufficiently well controlled and workmanship even in traditional metal working is careless. As a result the required properties of the output itself are inconsistent and on test prove to be outside specification. Every single item was outside the dimensional tolerances specified. As a result the British firm lost interest in placing further enquiries within the fSU. In the past it might have been acceptable for many items to be rejected on inspection in order to provide the military with good quality products. The costs involved of rejection and of rectification are insupportable in a competitive economy.

The whole culture of manufacturing operations has to undergo a drastic improvement if the defence industries are to be competitive. The ideas of research workers in military technology have often been excellent but their implementation in practice has been handicapped by poor industrial performance. The culture of quality assurance (QA) and reliability must be encouraged. It must be stressed that the mere introduction of systems such as ISO 9000 is no guarantee of quality assurance; it merely provides a basis, an aide memoire if you like, from which people must work. Quality depends on the managerial and technical ability and imagination of people to ensure that every aspect is considered and carried out correctly. QA is a continuous process of operation, supervision and management with the participation of supplier and customer in every link of the chain from metal extraction, polymerisation to final installation and performance of the ultimate product in service. Reliance on paper systems however complex and however they may be computerised is no substitute. When a customer knows that he can rely on the quality of supplies he can reduce his costly goods inward inspection operations, relying on sampling methods.

Given the appropriate effort, this sector may provide the most immediate and profitable source of sub-contract and successive stages of collaboration and participation in foreign markets. In the beginning many foreign firms have found it necessary to provide their suppliers in fSU and eastern Europe with materials and components. This is not only to ensure quality but also to provide for

interchangeability of components especially in electronics. This is essential to provide immediate support for customers through distributors. No one is prepared to have his operation standing idle while spare parts are provided from an overseas source.

**Delivery schedules** are another key aspect of modern trade in components. Not only the major producers such as car manufacturers but also the smaller, specialist firms are taking advantage of the "Just in time" delivery system pioneered by Toyota in Japan. The advantages to the customer are considerable: smaller warehouses, simpler and smaller materials handling systems, less capital tied up in stocks of raw materials and components. The advantage therefore is to local suppliers and to those who can use reliable road, rail, sea and air transport for delivery. Suppliers who are far away have to overcome their handicaps by using reliable transport and local distributors. This adds to their costs. The calculation of ex-works costs has to include the comparison between large occasional deliveries and regular frequent ones to meet JIT advantages.

Another example is to be found in the distribution systems for electrical and electronic components and products. RS Components Ltd, a British firm, provides a service with thousands of articles in its catalogue which is widely distributed to its customers and which is kept up to date not only on paper but through CD-ROM. It specialises on supplying the needs of customers who require only small quantities of a given item but who need it immediately. A call to RS before 1600 hrs ensures delivery anywhere in UK by 0900 the following day. They have subsidiary companies in Western Europe, Hongkong and in USA, which are linked to the main computer in England. They also distribute through agents; the ones in Kazakhstan and in Yekaterinburg have done substantial business even in their first year of operation. Naturally the price per item is higher than that for bulk supplies. The profit of RS is considerable. They only accept items for inclusion in their catalogue which pass their own and national standards for performance and safety.

Whatever is the motivation actual or ascribed to some other countries it is simply not true that the purpose of certification in Great Britain is to prevent competition from imported goods by certification procedures. Certification laboratories deal only with the technical aspects of acceptability in the market place; it's the Consumer Association's (CA) laboratory which examines the other aspects which affect consumer's choice. It provides a comparison with other articles on the market and recommends with reasons the ranking of competitive products. Russian industry would be well advised to follow up the suggestion that I made in 1989 to establish such a laboratory in Russia. Initially the manufacturers might have to pay for the work rather than consumers as they do abroad. The CA Movement in advanced industrialised countries has provided much of the information which has allowed the general population to improve its level of judgement of its purchasing intentions and decisions. As a result the pressure to improve products and services from the public on manufacturers and suppliers has been considerable.

## **Costing & Pricing**

The old Soviet laws that determine the freedom of a general director are largely still in operation. For example a state factory is obliged to cost a product on the basis of absorbing the full overheads of the organisation, even if it is largely idle. The GD is not allowed to price a product such that it will recover the variable costs and make a contribution to its own essential fixed costs and perhaps to the general overheads.

Such marginal costing and pricing is still an offence. This is not the case for privatised firms. Since the collapse of the USSR, the tax system has piled up a chaotic, set of taxes that if fully obeyed render an honest business impossible. Furthermore it is continually changing and as taxes are under-recovered perhaps because some firms are idle then the load on those still functioning is increased, rendering them even more unprofitable.

The standard soviet costing system is cumbersome, even fictional, and does not allow the true costs to be stated. Even private firms are subject to laws such as that which fines them if they pay wages more than six times the minimum wage. Consequently they show more workers than are needed and that they are paid less. In fact they claim that they will use fewer workers and pay them properly.

**Amortisation of equipment, buildings and land** is also unreal since the truth is a double-edged weapon. If it is set low, the profits are artificially high and will be taxed accordingly. If the figure reflects the replacement cost then the firm is taxed on the declared book value. And this in a state of high inflation. This is a subtle game that requires cunning to stay alive. Most factories have no idea of **inflation accounting**, they use old norms for use of services. Energy costs have been rising steeply but few firms know their costs, have little idea how to save energy. The labour productivity of most factories is appallingly low, probably within the range of one tenth to one fifth of our equivalent factories. The office bureaucracy is overstuffed and inefficient. The Ministries that they report to are also overstuffed; there are significantly more people in the State bureaucracy than there were in the USSR which had twice the present population of the Russian Federation. What with this load and that of the military which is still at least 12% of GDP, the Government at federal level is always short of money. Consequently it is always several months in arrears with its payments due to the military and to industry. Banks play the same game of withholding payment to creditors' account. They find it profitable to make money by earning interest at 200% a year and then paying it out late rather than serving commerce, industry and the rest. Consequently industry is starved of funds for all purposes. Factories plan on being paid in cash on delivery if they can.

The cost of borrowing is high. Taking into account all these facts, together with unrealistically low estimates of future costs and inflation it takes some effort, insight and imagination to discern anything like **true costs in a factory business plan**.

**Cross border trade in high value components such as electronic, even in semi-finished footwear, is complex.** Purchasers seek to take advantage not merely of low wage rates and advanced production systems and managements but also of specific tax incentives and Government grants for goods partly or wholly processed in their territories. For example a British firm currently orders partly finished footwear from a Russian factory, ships them to USA for completion and thereby attracts a US Government grant for exported goods which end up in the West European market.

The Russian defence industry must realise that current commercial and technical conditions in the "Global Village" of design and manufacture are putting the countries of the Pacific Rim in advantageous competitive positions relative to the AICs and even more so to the fSU and eastern Europe. The Russian defence industries must consider the Pacific Rim countries as their main competitors for sub contract and subsequently developed business from the AICs, rather than the

AICs themselves. This extends to software, programming, design of electronics as well as to manufacture itself.<sup>1</sup>

The success of the defence factories in working with and exporting to the West depends on them learning rapidly the culture of doing everything thoroughly; science and research play little part in this process.

## **Some Advice On Selling Innovation**

These fall into two categories: ideas for licensing and finished products for sale. To entice foreign investment one must make it easy for potential buyers to appreciate what is offered. Western firms are very busy, they have many offers to buy ideas and products and they require things to be simply, logically and informatively presented.

Let us take the first category, ideas for licensing. I have a lot of experience in commercialising innovations from academic institutions, by private inventors and from within industry. Based on this experience it is clear that the presentation of innovations should be improved in order to increase the interest and therefore the chances of getting contracts from foreign firms to exploit these ideas.

### **General Remarks Which Apply To Both Categories**

A good rule is to get the documentation translated by a practitioner in the field of the offer who is a native speaker of the language of the country you are addressing. Make sure that the translator knows the correct technical terms. Organise the data around categories such as physics, chemistry, materials and then into sub divisions such as lasers, optics, anti corrosion treatments and materials, diagnostic chemicals. Look at western catalogues especially mail order and you will get the idea. Write the data from the point of view of the potential buyer and not from that of the originator.

I therefore would like to offer the attached list of questions which apply to category one, the offer of intellectual property and which is essential both between western organisations and from FSU and the west.

Here are the reasons for each section. Potential buyers must know that the offers come from people who have full rights to the intellectual property offered. It is well known everywhere that various bodies collaborate, However if they do so as sub contractors normally the right to the property stays with the institute that commissions sub contracted work. However it is essential that the sub contractor realises this and does not later demand a share or hinder the negotiations between the main offering party and potential licensees.

It is essential that this section is completed but it need not be done at the first phase. For the potential buyer it is absolutely essential that the second section is completed in advance so that he can assess its worth. One has to remember that each product offered probably has many equivalents or almost equivalent competing products. It helps the assessor to know what they are from the outset. If you were

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<sup>1</sup> See "Innovation in East Asia, the challenge to Japan" by Michael Hobday, University of Sussex, UK, pub Edward Elgar, 1995, ISBN 1 85898 017 8. Of especial importance to Russian readers is Chapter 3, "the latecomer firm".

to rely only on the most likely user of each item who receives your document then he may look at it and find what interests him. However it is common here for an intermediary organisation to act as a broker of technology transfer and therefore he needs as much information as possible to decide if the idea has competitive merit and if so to which firm. The first step is for the inventor in Russia to do the basic work himself. It would be totally uneconomical for anyone else to do it. The legal section is set out on the assumption that the western collaborator is either such an intermediary or a directly interested party.

## ***SECTION 1 - LEGAL***

This can be delayed until a possible interested party is found in the west.

### **Authors Of The Innovation, Name(s) And Place Of Work.**

#### **Has Any Other Person Or Institute Contributed To The Work? If So Who?**

Please obtain a signature from them either acknowledging their share of the work and agreeing to the terms of collaboration or acknowledging that their work was not innovative and that they accept that they have no rights of authorship. You are asked to certify that clear title exists for the authors here named. You will be responsible for actions against you in your own country. Should it be decided to fund foreign patents, it will be the job of the licensee to police those patents at his expense. You will be asked to sign an exclusive agreement with an interested western party, probably for a period of 6 months. This will enable them to study the prospects for commercialising the idea at their own expense and to come to a conclusion whether to proceed or not. The agreement would be forwarded later on.

#### **Have You Applied For Patents? In Which Countries?**

If so please be ready to show the applications. The western side guarantees not to use or disclose your information to any third party unless it can prove to you that it has had the same data from other sources before your approach. A standard confidentiality agreement will be attached for your information. You are welcome to show it to your legal adviser.

## ***SECTION 2***

To be completed as soon as possible, fill in as much as you can.

### ***Short description of the innovation***

**What is it?** Aims of the innovation

**What does it achieve or what is it aimed at achieving?** Explain the advantages of achieving your stated aim. Why is this a worthwhile aim? Think what other aims might serve the ultimate objective of a user of the idea.

**How does it differ from other ways of achieving one or more of the aims?** Describe how people have managed to achieve in whole or in part the aims of your innovation before it appeared. Cite all forms known to you of potential competition to the innovation, giving references.

**What are the advantages claimed for the innovation over prior art?**

**Has it any disadvantages?**

**If so is it possible with future work to reduce their effect?**

**Compare the innovation with the prior art?** Setting out all forms of comparison, eg economy, speed of realisation of given aims, better accuracy etc.

**What are the main areas of application that are envisaged for the innovation?** The more generic the idea the wider its application is likely to be.

**At what stage is the innovation?**

**What aspects have been checked so far?**

### ***Technical and Production***

Laboratory experiment, *bread* board or technical prototype.

Methods of getting it into production.

Any special features of further experiment and technical development? ie any scarce materials, components required, any safety hazards, special processing equipment needed etc. Give results as concisely but as fully as possible.

### ***Commercial***

**What kind of market is there?**

**How big is it in your opinion?**

**Have you talked to any potential users?**

**With what result?** Record what data is available.

**What is the possible range of price that users may be prepared to pay in your country and in an advanced industrial country?** Try to compare like with like, ie ex-factory price if possible. Cite catalogue prices quoted in advertisements of competitors if nothing better is available. Cite costs of doing the job by existing ways with which you intend to compete. Give your sources.

**What commercial contacts have you had so far?**

**What have been the reactions of the people whom you approached?**

### ***Financial***

List the elements and quantities that make up the innovation, if you can and estimate their current costs to you. This includes materials, labour, use of equipment,

If you can, list the steps and what is needed to complete the development phases from now through production till commercialisation.

## ***Section 3 - Explanation Of Modus Operandi***

### ***Next phase of collaboration***

The West will study your statement, make a rapid assessment of its claims for novelty and potential application. It may be essential to discuss preliminary findings with you and to ask some questions. It will be in your interests for these to be answered as fully, frankly and promptly as possible.

If this first phase is satisfactory, the idea, under seal of confidentiality, can go to expert referees knowledgeable in the field and also in those of potential use. Their report will guide the next phase. Our experience in commercialising innovations is that we can identify potential buyers quickly. However the more important and potentially valuable the idea the more likely it is that we shall be approaching large powerful companies. You will understand that these firms have their own procedures for evaluating ideas and that this takes time before they would even decide to visit you for direct discussions. However six months should be enough time to take discussions with one or even two such firms sequentially.

We may have to suggest an extension to the period of the exclusivity agreement should the idea be declined by several firms and if we think it is worth approaching others. However, the more an idea is taken round the market the lower its potential becomes.

**Basis of share of income in case of success.** You should normally aim at payment of a lump sum, perhaps as an advance on royalties plus a continuing annual royalty for an agreed period.

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