# The Impact of Trade Barriers on Export Strategies: Evidence from India

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**Abstract:**

The European Union (EU) and India are currently negotiating a bilateral free trade agreement (FTA) that aims to eliminate tariffs and other barriers to trade. This paper identifies export problems faced by Indian firms in the EU. Using factor and cluster analysis (SPSS version 16), the results show exporting firms largely encounter external-foreign problems such as regulation and standards as well as customs and administrative formalities that impacts on firms’ strategy orientation. From a policy perspective, addressing export problems are crucial within the ambit of ongoing FTA negotiations and that if the proposed FTA is to achieve its potential and bestow benefits to exporters, the governments may have to play a proactive role to help firms overcome export problems.

*JEL classification*: F15, O19, M38

*Keywords*: Integration, development, government policy and regulation

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## Introduction

There is a growing body of literature on the impact of both globalisation and regional integration agreements on international business as well as on the issue of internationalisation of firms via exporting (Hamel & Prahalad, 1996; Morrison *et al*, 1998; Falbe & Welsh 1998; Pett & Wolff, 2000; 2003; Keddia & Chhoker, 1986; Bell, 1995; Leonidou 1995a, b; Leonidou & Katsikeas, 1996; Morgan, 1997). Studies that identify problems firms face in exporting are scarce and relatively out dated and do not address the changing business environment as a result of increasing bilateral and regional trade agreements (Bauerschmidt *et al*., 1985; Yang, 1988; Sharkey *et al*., 1989; Gripsrud, 1990; Ramaswami & Yang, 1990; Yang *et al.,* 1992). The European Union (EU) and India are presently negotiating a free trade agreement (FTA), which aims to eliminate tariffs within a 7-year time frame with the target implementation date as 2010-11. Such an agreement could transform the overall business environment from the interconnectedness of these trading economies. Bilkey (1978) suggests that if trade agreements between countries and/or economic blocs are to achieve their potential and bestow benefits public policy may be required to help firms in overcoming export problems. This has also been identified as an important issue that needs to be addressed within the ongoing EU-India FTA negotiations (Khorana & Perdikis, forthcoming).

This paper focuses on the perceptions of export problems faced by Indian small and medium firms. The aim is two-fold: firstly, to evaluate Indian exporters’ perceptions to problems faced in the EU market that might result in some firms not exploiting full potential; and secondly, to suggest policies that might be required to ensure that Indian exporters benefit from increased market access under the FTA framework. The remainder of this paper is organised as follows: section 2 presents the research framework. Section 3 discusses the sample selection and measurement of variables. Section 4 deals with data analysis, model estimation and the research findings. Section 5 concludes by drawing out the implications for exporters and public policy needs of the proposed EU-India FTA.

## Research Framework

Literature makes a clear distinction between export barriers and problems faced by firms (Morgan & Katsikeas, 1997). The former refers to factors that prevent non-exporters from embarking on an export strategy while the latter refers to stumbling blocks encountered by existing exporting firms. It also emerges that exporters perceptions to barriers faced in foreign market are determined by firm size, export involvement and international experience. Studies show that the perception of barriers and problems affects exporters’ strategic decisions on the level of resources firms commit to exporting (Shoham & Abaum, 1995; Katsikeas *et al*, 2000) and exporters perceptions are defined as the mindset or familiarity with conditions generating their changing environmental setting (Falbe & Welsh, 1998). Export manager’s perceptions of trade barriers and problems are important as these in turn determine exporters’ sales strategies and resources committed to pursue internationalisation (Leonidou & Katsikeas, 1996). Studies highlight the effect of firm size on export activity of a firm and show that firm size is an important factor in shaping exporters perceptions of trade problems and barriers (Fillion, 1990). Large firms with greater resources at their disposal can respond better than their smaller counterparts in dealing with trade problems and are likely to have a competitive advantage in international markets (Beamish *et al*., 1999; Wolff & Pett, 2000). The argument goes that large firms having built up and developed their resources and capabilities over time are able to carry out export activities from a well developed base. In this vein it follows that large firms, having acquired a blend of necessary resources such as managerial know-how and export departments, are more likely to overcome problems to exporting than smaller firms. Aaby & Slater (1989) suggest that larger companies have size-related advantages that enable them to have more effective engagement in export activity. An efficient production structure, therefore, allows firms to penetrate markets on a larger scale and broad information network increases firm capability to compete in foreign markets resulting in higher export volumes and performance. Moini (1995) also shows that export activity and success are positively correlated with firm size. Researchers, drawing on the insights of the resource based theory, also find that firm size matters in determining export success (Barney, 1991). Large firms are usually older and have accumulated the relevant stock of resources to ensure success when faced with export challenges (Mohan-Neill, 1995). This implies large exporting firms are less likely to face problems in exploiting cross border opportunities, as a result of scarce resources, inadequate organisation, and incompetent management, and that large firms are less likely to perceive export barriers and problems as a challenge compared to smaller firms. Ghauri & Kumar (1989) contend that firm size impacts the perception of impediments to trade such that small firms consider barriers and problems to exporting much more significant that large firms and that the significance of barriers for smaller firms is more than for larger firms. The perception of barriers and problems also varies based on whether the exporters are passive or active exporters (Sharkey, *et al*, 1989). On the other hand, studies show that small and medium exporting firms face obstacles from organisational weaknesses, strategic business flaws, home country deficiencies or host market problems which often lead to deteriorating performance that at times places the survival of these firms at stake (Leonidou & Katsikeas, 1996).

Findings show that perceptions of export barriers and problems faced by firms are correlated with export experience (Barkema *et al*., 1996). Kneller & Pisu (2007) suggest that exports barriers and problems do not affect all firms in the same way and that the best predictor of whether a particular firm identifies a problem as relevant is explained almost exclusively by the number of years the firm has been exporting. The perception of impediments varies between firms, such that firms with little experience perceive higher incidence of problems in international business (Madsen, 1989). This implies that experience can be an essential factor to the success of exporters in overcoming and tackling export barriers and problems (Reuber & Fischer, 1997). Literature reveals different sources of barriers and problems affect firms’ export performance (Ramaswami & Yang, 1990; Katsikeas, *et al*., 1995; Morgan, 1997; Leonidou, 1995a, b; 2004). For instance, Ramaswami & Yang (1990) suggest ‘procedural barriers’ are important which manifest as lack of knowledge, internal resource constraints, procedural barriers and other exogenous variables. Others highlight quality control and safety standards as important problems faced by exporters that compel firms to adapt products to the requirements of various foreign markets (Kedia & Chhokar, 1986; Keng & Jiuan, 1989). Yet others find transportation and distribution difficulties are faced by exporting firms in foreign markets (Kedia & Chhokar, 1986; Barker & Kaynak, 1992) that manifests into a barrier through high transport costs (Pinney, 1971). Johanson & Weidersheim-Paul (1975), Johanson & Vahlne (1990) find that the lack of knowledge about foreign markets is yet another inherent problem faced by the small and medium sized exporters. More recent studies confirm that firms face export barriers in the form of imperfect distribution of information between buyers and sellers, which translates into additional costs to obtain basic information about export markets, identifying first contact point, as well as divergences in culture as main factors that manifest as export impediments in international trade (Kneller & Pisu, 2007). Anderson & Wincoop (2004) also show that trade costs are associated with export barriers, instance of these are language differences, imperfect information and institutional quality. Leonidou (1995b, 2004) categorises export problems as internal and external to the firm. On the one hand, internal barriers are intrinsic to firms and usually associated with available organisational resources or approach to export marketing. On the other, external barriers stem from the environment within which firms operate.[[4]](#footnote-5) Morgan’s (1997) developed the conceptual domain of export stimuli and barriers which forms the basis of the theoretical construct employed by this study to categorise export problems faced by Indian exporters into: internal-domestic, internal-foreign, external-domestic and external-foreign problems.

In India, the major problems that exporters face are standards, testing, labelling and certification as well as internal domestic barriers like inadequate infrastructure, high transport costs and corruption. The OECD (2005) conducted a survey of Indian firms exporting to the EU and identified the main problems as labelling requirements (fabrics, apparel, textiles); technical standards (leather goods, coffee, tea, pharmaceuticals and electrical machinery); anti-dumping measures (chemicals, man-made staple fibres, iron and steel bars); and, child labour laws (carpets and floor covering). Studies show that high port fees and taxes and that the fee for authentication of export documents by the consulates of importing countries adds significantly to total costs for the exporter (Mehta, 2005). Strict rules of origin are also cited as another important problem faced by Indian exporters in textiles and clothing. Instances of these are non-recognition of processes conferring origin to the final product as well as discriminatory and unilateral changes in rules by the importing countries. In leather and footwear, the most common problems faced by exporters relate to animal health, safety concerns and unethical treatment of animals (WTO, 2003).

## Research methodology

For this study data was collected, via a questionnaire, from sixty companies exporting textile and clothing and leather and footwear products from India to the EU.[[5]](#footnote-6) Firms, selected for the survey were based on firm level information held by the Council for Leather Exporters, the Apparel Export Promotion Council and the Confederation of the Indian Textile Industry. The geographical spread of the sample covered the whole of India but focussed inevitably on the main sector hubs for the production of leather and footwear goods and textiles and apparel. The exporters interviewed were located in the southern, northern and western hubs for textiles; and south, north and east for leather and footwear.[[6]](#footnote-7) The interview questionnaire had two parts: the first part included questions on exporting firms’ characteristics, e.g. the firm’s main sector of activity, total turnover, total number of employees, total years of production and export experience. In the second part of the questionnaire, exporters were asked to rank their perception on the incidence of problems faced in exporting.

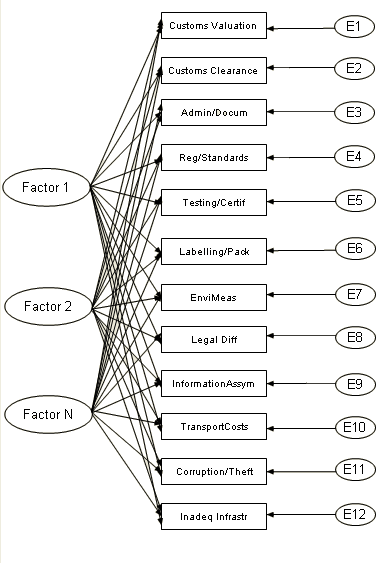
An ordered five point Likert scale[[7]](#footnote-8) required the respondents to indicate one option best aligned with their views and to rate their perception on the incidence of various export problems faced in current EU-India trade. Responses were obtained on a five point scale ranging from “very significant barrier” (5) to “not an issue at all” (1), i.e., this was not perceived to be a barrier because the respondents did not face this barrier in trading with the EU. On the basis of an earlier OECD study (2005) on Indian firms’ experience in the EU and Morgan’s (1997) taxonomy of trade barriers, this study classifies export problems in two main groups: external-foreign and internal-foreign.[[8]](#footnote-9) As the name suggests external-foreign problems arise in foreign-external environment of the exporting firms that encompasses a lack of socio-cultural and linguistic awareness and wider market knowledge as well as pricing and competitive pressures. This paper defines external-foreign problems as customs valuation and clearances, administrative and documentary formalities, foreign regulations and standards, legal differences, problems complying with testing and certification, labelling and packaging as well as environmental requirements. Internal-foreign export problems, originate from exporters’ organisational structure, are include issues like high transport and distributional costs, payment delays and ineffective communication with foreign distributors as a direct consequence of information asymmetry and domestic infrastructure problems as well as corruption and theft.

## Data Analysis, model estimation and findings

Factor and cluster analysis are employed to analyse the data on Indian exporters’ perceptions about the problems faced in the EU market. Cross tabulation allows drawing inference about the relationship between exporters’ perceptions and exogenous variables like firm size, number of employees and exporters’ experience. While the first part of the analysis draws inference from endogenously identified problems, in the second part, we attempt to quantify firms’ priorities and strategy orientation towards these perceptions. In this model, as a first step the exploratory factor analysis (EFA) identifies latent variables (factors) that reflect Indian exporters’ perceptions to problems in the EU. In the second step, following the methodology of Salavou and Halikias (2009), cluster analysis (SPSS version 16) allows grouping all exporting firms into different clusters. Finally, cross-tabulation between export problems and firms’ perceptions shows strategy orientation of Indian small and medium exporting firms included in the sample.[[9]](#footnote-10)

Figure 1 shows the common factor model for *N* factors and export problems faced by firms in the EU. Factors 1 to *N* refer to unobserved indicators and *E1* to *E12* are measurement errors.

Figure : Exploratory Factor Analysis



The factor model for our sample data is:

 (1)

Where:

: Sample covariance matrix

B: Weights assigned to the factors

: Common factors correlation matrix, and

: sample error

Table 1 shows that 5 factors with a standardised factor loading below 0.60 are excluded given these do not “load” in the factors as they lie outside the optimum and minimum range of factor loadings. According to Hair *et al.* (2005), the appropriate sample size for EFA with 12 factor loadings is 60 observations. Standardised factor loadings must also be above 0.5 and “ideally” exceed 0.70 to be successfully “loaded” in the common factors (Gallagher *et al*., 2008). On this basis factors identified as relevant in our model are customs valuation; customs clearance; administration and documentation formalities; regulations and standards; infrastructure; and, transportation costs. Those excluded are: testing & certification, labelling & packaging, environmental measures, legal differences and information asymmetry.

Table

|  |  |  |  |
| --- | --- | --- | --- |
|  | Factor Loadings a | | |
| Variables | Factor 1 | Factor 2 | Factor 3 |
| Customs Valuation | 0.78 |  |  |
| Customs Clearance | 0.83 |  |  |
| Administration and Documentation. Formalities | 0.79 |  |  |
| Regulations and Standards | 0.65 |  |  |
| Testing and Certification |  | 0.57 |  |
| Labelling and Packaging |  | 0.44 |  |
| Environmental Measures |  | 0.43 |  |
| Legal Differences |  | 0.56 |  |
| Information Asymmetry |  | 0.56 |  |
| Transport costs |  |  | 0.74 |
| Corruption and Theft |  |  | 0.89 |
| Inadequate Infrastructure |  |  | 0.87 |
| ***Note****: a Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. Rotation converged after 3 iterations.* | | | |

The results (Table 1) suggest that Indian exporters can be grouped into two main categories on the basis of problems faced in the target market. These are: external-foreign problems that largely originate in the foreign-external environment of firms; and, internal-foreign problems arising from exporters’ management organisational structure.

In the second stage, cluster analysis examines the extent to which exporting firms cluster around different factors, i.e. external-foreign and internal-foreign. Using factor variables identified as relevant (in the first stage), cluster analysis investigates how these groups provide an insight into firms’ perceptions to export problems in the EU market. In this case clusters are allowed to vary which assists in identifying firms based on their exogenous variables.

Table : Cluster Analysis

|  |  |  |
| --- | --- | --- |
|  | **Final Cluster Centres a** | |
| **Factors** | **Cluster 1** | **Cluster 2** |
| Factor 1: External-foreign | 0.35 | -0.89 |
| Factor 2: Internal-foreign | -0.34 | 0.86 |
| No. of cases in each cluster | 43 | 17 |
| ***Note****: a Factors are standardised (equal cluster contribution) with the K-means cluster analysis of SPSS v.16* | | |

Consistent with earlier studies (Salavou and Halikias, 2009) these factors are standardised (equal cluster contribution) with the K-means cluster analysis. The analysis reveals that 43 firms fall in Cluster 1 and the remaining 17 in Cluster 2. The results are validated with the one-way analysis of variance (ANOVA) which tests the robustness of firms’ perception of these clusters and validates the homogeneity-within-and-difference-between criterion (p≤ 0.01). The results are significant at 1%; an exception is regulations and standards for which the results are significant only at 5%.

Table 3: One-way Analysis of Variance

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Clusters | |  |  |
|  | External-foreign | Internal-foreign | *F* | *p-value* |
| Customs Valuation | 2.87 | 2.27 | 7.1 | 0.01 |
| Customs Clearance | 3.27 | 2.22 | 13.1 | < 0.001 |
| Admin and Documentation. formalities | 3.05 | 1.89 | 20.5 | < 0.001 |
| Regulations and Standards | 2.41 | 2.05 | 3.75 | 0.05 |
| Transport costs | 2.00 | 3.30 | 10.65 | < 0.001 |
| Corruption and Theft | 1.75 | 3.61 | 24.19 | < 0.001 |
| Inadequate Infrastructure | 2.37 | 3.82 | 7.96 | 0.01 |
| ***Note****: Maximum values are underlined. The F test and p-values are taken from ANOVA analysis. Significance level is based on one-way ANOVA.* | | | | |

The results highlight the importance of internal-foreign factors like transport costs, infrastructure corruption and theft. Within the Indian context, the power sector faces severe capacity shortages, with poor reliability, frequent black-outs, and low per capita consumption. High electricity prices increase the total cost for firms and undermines their capacity to focus production on higher value-added segments in the supply chain. Disruptions in electricity supplies including frequent power stoppages, fluctuations and transmission losses are another aspect of infrastructural problems commonly experienced by exporters in India. Second, transportation problems caused by delays on roads and congestion at ports leads to high inventory costs which affects export competitiveness adversely. Third, there are frequent strikes that lead to delays in loading containers which add to the total warehousing costs and even lead to missing shipping deadlines. Besides, exporters often resort to “speed money” to expedite the approval procedure which explains why exporters perceive corruption as a barrier to exports.

Table 4 shows how exporters’ perceptions impact on firms’ strategy orientation. The results show that most firms focus on addressing the external-foreign problems within the business environment with only a small number prioritising addressing the internal-foreign problems over external-foreign problems.

Table 4: Strategy orientation of exporting firms

|  |  |  |
| --- | --- | --- |
| Factors | Clusters | |
|  | External-foreign | Internal-foreign |
| Factor 1 | *High* | *Low* |
| Factor 2 | *Low* | *High* |

This suggests that firms in cluster 1 are orientated to address external-foreign problems like customs procedures, administrative and regulatory barriers. Cluster 2 relates to firms orientation to address internal-foreign problems associated with exporters’ resources, capabilities and overall business strategies so that firms in this cluster are affected by barriers usually outside the scope of individual exporters.

Table 5 analyses the relationship between firms’ strategy-orientation and characteristics. The descriptive statistics show that external-foreign factors affect small exporters (defined in terms of employee size and turnover) while the larger firms are mainly affected by internal-foreign factors. In contrast, firms with more export experience are affected by external-foreign factors while those with less experience tend to be impacted by internal-foreign factors.

Table 5: Descriptive statistics

|  |  |  |
| --- | --- | --- |
|  | Clusters | |
|  | External-foreign | Internal-foreign |
| Turnover | 5.02E+08 (6.1E+08) | 8.41E+08 (1.73E+09) |
| No. of Employees | 777.65 (1666) | 1857.18 (5480) |
| Export Experience | 20.79 (11.51) | 19.12 (16.03) |
| ***Note:*** *The number of cases for the external-foreign (internal-foreign) firms is 43 (17). Mean values are presented. Standard deviation is in parentheses.* | | |

From a policy perspective, results show that for the Indian government to be able to support its exporters it is crucial to address the external-foreign barriers faced by Indian exporters within ongoing negotiations. Steps to ameliorate internal-foreign barriers are equally vital and are addressed in the following section.

## Conclusions and policy implications

This study contributes to the limited literature on problems that impede leather and footwear as well as textile and clothing exports from India to the EU. The main focus of this paper is identifying export problems and strategy-orientation of Indian firms exporting in the present EU-India business environment. There are policy implications as the statistical results show firms react differently to export problems. The results reveal Indian exporters cluster their perceptions implicitly around external-foreign and internal-foreign and their strategic priorities. A large majority of exporters prioritise external-foreign problems with only a few focussing on addressing internal-foreign problems. To ensure that benefits of the proposed agreement are reaped by Indian exporters it is important that policy at the micro level be tailored to the specific needs of small and medium exporters.

Given the proposed FTA aims to enhance market access for partner countries identifying export problems and addressing these are of particular importance from the perspective of Indian exporters. The Indian government can address external-foreign problems by prioritising these as negotiating issues in the ongoing FTA talks. To address the problem of regulatory divergence between the EU and India, pre-standard-setting harmonisation is suggested in the immediate short term. As a first step, this will involve an identification of all products for which minimum (rather than higher) standards and regulations are imposed by the EU buyers. Information dissemination among Indian exporters is necessary on mandatory technical standards and regulations. Second, notifications on voluntary standards are required to provide exporters with necessary additional compliance information. We propose a collaborative approach between the EU and India to pre-standard setting harmonisation so that information on technical standards and regulations is updated. The Indian government should complement this approach with domestic support measures to build up domestic industry capacity. In the medium term, a phased approach to regulatory harmonisation is proposed. Harmonisation of the regulatory regimes is proposed to be carried out in three steps: design; notification; and, enforcement of regulations and standards. To achieve the objective of harmonisation (i.e. standards, testing and certification, labelling and packaging regulations) we propose that modalities should provide for consultations with exporters being the affected party. In the long term, harmonisation and regulatory convergence needs be achieved with technology transfer. Technical transfer and up-grading of technology in small scale and medium sized firms will help exporters gain access to technology managerial skills, marketing and equipment. Improvements in technology are also critical to enable the small and new exporting firms to implement buyer specific technical regulations. In addition, necessary steps are required to reduce the existing administrative documentation formalities that manifest as a problem for exporters.

From a trade policy perspective, internal-foreign problems need to be tackled by the Indian government to ensure efficiency in transportation, telecommunications and electricity as this will lead to a positive spill over effect on the economy. Firstly, it will reduce overall transit time which will allow exporters to produce within lower lead production time. Secondly, an efficient infrastructural framework will help exporters to exercise effective control over all elements of the supply chain. A reliable infrastructure will, therefore, confer a competitive edge on the Indian exporters. An important way forward to address the infrastructure constraint is to augment the existing infrastructure and create sustainable infrastructural linkages. Besides, active labour market programmes and policies[[10]](#footnote-11) (ALMPs) need to be strengthened. To make the labour market dynamic we suggest providing for more technical, vocational education programs and have dynamically functioning employment exchanges.

Broad policy implications suggest that the Indian government, should in collaboration with the EU, aim for an overall technical up-grading, diffusion and modernisation of production processes. Efforts should focus specifically on cleaner process technologies, reducing effluents by promoting the use of eco-friendly chemicals and minimising waste. To conclude, differences in existing regulatory regimes across the EU and India should be addressed through the ongoing negotiations. The Indian government, however, needs to complement these measures by taking steps to address domestic problems that impact adversely on exports.

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4. These barriers are subdivided further into internal resource problems, procedural and distribution difficulties, foreign market factors, knowledge and experience, socio-economic and managerial issues (Kaleka & Katsikeas, 1995; Leonidou, 1995 a, b). [↑](#footnote-ref-5)
5. Trade data shows that textiles and clothing and footwear and leather exports comprise over one-third of total Indian exports which makes it relevant to analyse exporters’ perceptions from the policy perspective. [↑](#footnote-ref-6)
6. The Southern hub is mainly Tirupur (knitwear cotton), Coimbatore (yarn) Erode (yarn and fabrics), and Bangalore (basic and fashion garments). In the West, the main hub is Mumbai (for made-ups and fashion garments); this is Delhi, Noida and Gurgaon (for fashion and basic garments) in the North. Leather and footwear hubs interviewed were south (Chennai), north (Agra and Kanpur for footwear manufacturing; Delhi) and east (Kolkata - leather accessories). [↑](#footnote-ref-7)
7. R. Likert in “A Technique for the Measurement of Attitudes,” Archives of Psychology, No.140, 1932, p.55. [↑](#footnote-ref-8)
8. The review and assessment of the conceptual, methodological, and empirical aspects of available extant research on export problems shows that empirical findings do not yield any specific uniform pattern in the rank order of the various export barriers or problems (Leonidou, 1995b). This is attributed to a large extent to various international, national, industry, and company specific factors, as well as to differences in the methodologies employed by researchers. Research shows that, on the one hand, it is possible to identify a limited number of problems capable of summarising the complete set of impediments to exports. On the other, that there is no consensus about either the number of underlying factors or the exact content of each of these. As a result it is difficult to clusters export problems and this study employs EFA to classify variables. [↑](#footnote-ref-9)
9. Given there is no clear relationship between export problems and the number of common factors, explanatory factor analysis (EFA) is progressed over the Confirmatory Factor Analysis (CFA) models. EFA uses principal component analysis with Varimax rotation (and Kaiser Normalisation with SPSS v.16). [↑](#footnote-ref-10)
10. ALMP was recommended by the International Labour Organisation (ILO). ALMPs have been sub-divided broadly into three categories: direct job creation, labour market training, and job brokerage (improving the match between job seekers and vacancies). [↑](#footnote-ref-11)