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Transport And Tariff Effects On exporting Cixifeilong Electrical Appliance Case Study

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Abstract *cixifeilong Electrical Appliance Case Study Is A Competitiveness Advantage In Other Emerging Markets Compared To China That Involves A Cost-Saving Approach To Help In Making Adequate Investment Decision. In This Paper We Use Mainly Mathematical Tools To Support Our Finding And Results By Using A Linear Function For Our Analysis Reflected In Illustrative Set Of Graphs To Show Eventually Cost Saving Between Two Emergent Markets (China And Morocco). This Result Allows Feilong Company To Implement The Optimal Investment In Morocco And Reduce Transport Time As Well As Product Cost By Up To 37% That Will Help Feilong Company Certainly To Increase Its Turnover With European Market And More Specifically France Market*

Keywords*: Maritime Transport Cost, European Tariff Barriers, Investment In Emerging Market*

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I. Introduction

The Final Quarter Of The Twentieth Century Has Witnessed A Remarkable Economic Transformation ,That Took Place In China. In 1978, Under The Leadership Of Deng Xiaoping, China Opened Its Trade Doors To The Outside World. This "Open Door" Policy Permitted An Almost Sudden Increase In Foreign Trade, Joint Venture Partnerships And Even Tourism. In Turn, Such Increases Have Led To An Average Economic Growth Of About 10 Percent Per Year In The 1980s (O'Keefe And O'Keefe, 1997).This Transformation Will Continue To Grow In Importance Both Politically And Economically. Several Key Factors Have Been Attracting Foreign Investors To China. Three Of These Factors Are Highlighted Here. First, Western Business People Have Eyed The Huge Chinese Market For Centuries (Gilsdorf,1997). One Reason Is That China Is A Country With More Than 1.3 Billion People, A Potential Market Size. Second, The Chinese Government Intends To Provide A Stable, Yet Exciting Investment Environment (Leung And Yeung, 1995).).Third, Is The Resources Available Within The Country, Specifically The People. China Has More Than 1.3 Billion People With A Well Structured And Competitive Education System .It Has An Illiteracy Rate Of Only 7.8 Percent Of The Population (Statistical Yearbook, 1997). Therefore China Has Become In Few Years The World's Leading Manufacturer, But Due To Many Barriers Implemented By US And EU Toward China; Such As Tariffs Barriers, Currency Pressure And The Increasing Freight Cost, Exporting Some Goods With High Turnover Is Becoming Difficult. Of Course China Doesn't Intend To Delocalize Its Manufactures, As It Solves The Unemployment Issue. However Until Now Some Products Could Never Be Exported From China To Some European Market Which Their Location Is Close To Other Emergent Markets "Morocco".

CIXI FEILONG ELECTRICAL APPLIANCE CO., LTD. Is An Example Of One Those Chinese Manufacturers Having Difficultiesin Exporting Their Goods To Some European Markets. Therefore The Following Paper Will Illustrate The Problematic From Its Root And Provide Subsequently Optimal Solutions.

II. Background

CIXI FEILONG ELECTRICAL APPLIANCE CO., LTD Company Is Specialized In Manufacturing Twin-Tub Washing Machines, Automatic Washing Machines, Dryers, Refrigerators And Freezers As Its Leading Products. It Has More Than 320 Marketing Agencies In Nearly Every Major City And Province In China And Also Owns Unified National After-Sales Service With Plans Being Made To Set Up More Marketing And Distribution Agencies Over The World. The Company Currently Covers 192 Thousand Square Meters Over Several Factories Now It Has A Staff Of More Than 2100, Including Over 300 Management Personnel & Technical Personnel.

1.0 Problem

After A Global Analysis Of Feilongcompany Performance, We Figure Out This Company Has A Major Problem Of A Small Market Share In Europe Due To The Following Problem:

1. Transport Cost Of Manufactured Goods
2. European Tariff Barriers
3. Currency Impact On Cost Competitiveness

Since Some Artificial Barriers Are Implementing By European Countries To Protect Their Imports Flow, Many Alternative Studies Can Be Conducted In The Aim To Help Companies Make The Right Decision If The Later Problem Persists, One Of The Main Critical Success Factors Is Investment As It Is A Major Factor Of Growth. The Swelling Of The Investment Is A Basic Explanation Of The Long-Term Growth Of GDP.(R. HEILBRONER Et L.THUROW, (1986).It Is An Operation That Is For A Company Or A Country To Increase The Stock, Means Of Production (Machinery, Equipment Of All Types, Infrastructure, Goods Of All Kinds, But Also Knowledge And Training Of Employees), With Prospect Of Future Production. It Is Gross Or Net Revenue, Depending Whether Or Not On Taking Into Account The Wear And Maintenance Of Durable Goods Involved In The Production (If Gross Investment Is Less Than The Wear, We Say That There Is A Disinvestment) ." E. COMBE, (1996).

When It Comes To Finance Sector, Investment Is Putting Money Into Something With The Expectation Of Gain That Upon Thorough Analysis Has A High Degree Of Security Of Principle, As Well As Security Of Return, Within An Expected Period Of Time. In Contrast Putting Money Into Something With An Expectation Of Gain Without Thorough Analysis, Without Security Of Principal, And Without Security Of Return Is Speculation Or Gambling.

According To The Economic Lexicon, (SILEM And ALBERTINI)[5]; Four Senses Of Investment Have Been Proposed:

- -In Its Narrow Sense, The Investment Means The Purchase Of Productive Asset In Order To Operate A Business And Reach A Level Or An Increase In Production Capacity;
- In Its Broadest Sense, It Is The Acquisition Of Capital In Order To Collect Or Consume Its Income;
- For Its Particular Meaning And Familiar, It Is A Synonym Of Placement, Putting Aside Of A Durable Consumer With A View To Resale Or Later Consumption;
- And Finally, At The National Level, Investment Is Thus A Renewal Of Equipment And The Increase Made During A Period Of Patrimony

The Investment Is Also Determined By The Relative Price Of Factors, Since The Production Function Is One Of Substitute Factors. Indeed, If The Price Of Labor Rises Compared To The Price Of Capital Input, The Entrepreneur Substitutes Capital For Work. (COMBE E., *Op. Cit*, P.28)

1.1 Objective

According To The Problem Statement In Section 1.2, Our Objective For This Paper Is Obviouslyto Reduce The Transportation Cost By Checking Whether It Is Beneficial To Invest In Other Emerging Market By Taking Into Consideration Two Major Elements Independently, That Is To Say Tariff As A"Constant"And Currency Rate As A "Variable"

1.2 General Data For Comparative Research

- Company Name: FEILONG ELECTRICAL APPLIANCE CO., LTD
- Target Market: France
- Product Name: Professional Washing Machine
- Washing Capacity: 8.0kg
- Carton Dimension (Mm)/Pc : 810 X 480 X 940
- HS Code28: 8450120000
- Tariff Rate: 2.7%
- Product Cost In China: $60 / Unit
- Transport Cost Form Ningbo To Le Haver: $2200
- Transport Cost From Tangier To Le Haver: $800

The Above Fret Costs Are Provided By International Cargo Logistics And They Are Variable With A Correlation Of 36%. Before Conducting Our Studywe Should Calculate The Loading Capacity For One TEU (20 Feet Container), And Subsequently The Total Amount Cost For A Given Number Of TEU

Loading Capacity = $\left(\frac{28\ \text{Cbm}}{810*\ 480\ *940}\right)$* 109

Loading Capacity = $\left(\frac{28}{0.365472}\right)$ = 76 Pcs

Total Amount

$76 * x * \sum_{i=1}^{n} N_i = TA$, Whereas N Represents Number Of Container (N_1 , N_2 , N_3 ....), And X Refers To

Product Cost

1.3 List Of Assumptions

Assumption 1: MOQ Is 1 TEU
Assumption 2: The Product Cost Price In Morocco Is 20% Higher Than In China
Assumption 3: Fob Prices Are Calculated With Taking Into Consideration The Investment Cost
Assumption4: FEILONG ELECTRICAL APPLIANCE CO., LTD Has A Representative Office In France; Therefore It Will Export For Its Self
Assumption 5: VAT Is Not Taking Into Consideration, Our Calculations Are HT

1.4 List Of Acronyms

- TR = Tariff Rate
- PCFR Lehaver1: Price At Lehaver Port For FLC 20 Shipped From China
- PCFR Lehaver2: Price At Lehaver Port For FLC 20 Shipped From Morocco
- GP1: The Gross Value For The Total Order Coming From China After Adding The Tariff
- GP2: The Gross Value For The Total Order Coming From Morocco
- N: Number Of 20" Container
- PFOB Shanghai:Price Of FLC 20" From Fob Shanghai
- PFOB Tangier Med: Price Of FLC 20" From Fob Tangier Med
- Fret1: Fret Cost Of FLC 20" From Shanghai To LEHAVER
- Fret2: Fret Cost Of FLC 20" From Tangier Med To LEHAVER

The General Formulas Are Represented Below:

- Tariffs = Rate (%) X Customs Value
- Customs Value = Value Of Product + Cost Of Transportation + Insurance
- PCFR Lehaver1 = (PFOB Shanghai+ Fret1)
- PCFR Lehaver2 = (PFOB Tangier + Fret2)
- GP1= N * **{** (TR * PCFR Lehaver1) + PCFR Lehaver1 **}**
- GP2 = N * PCFR Lehaver2
- Tariffs = Rate (%) X PCFR Lehaver1

III. Transport Effect

One Of The Main Difficulties In Analyzing Transport Effect Is That Of Obtaining Reliable Data. In The Recent Economic Literature There Have Been Numerouschallenges To Measure Transport Effects In Direct Or Indirect Way. Many Authors Used CIF/FOB Ratios As A Proxy For Shipping Costs (Baier And Bergstrand, 2001, Limao And Venables, 2001; Radelet And Sachs, 1998). Since Most Importing Countries Report Trade Flows Inclusive Of Freight And Insurance (Cif) And Exporting Countries Report Trade Flows Exclusive Of Freight And Insurance (Fob), Transport Costs, Including Insurance Costs Can Be Calculated As The Difference Of Both Flows For The Same Aggregate Trade (Martínez-Zarzoso And Gordon Wilmsmeier 2008). However, Hummels (2001) Showed That Importer Cif/Fob Ratios Constructed From IMF Sources Are Poor Proxies For Cross-Sectional Variation In Transport Costs And Such A Variable Provides No Information About The Time Series Variation. Ogueldo And Mcphee (1994) Also Doubted The Usefulness Of Cif/Fob Ratios From IMF Sources As A Proxy Of Transportation Costs. Hummels (2001, 2007) Used Data On Transport Costs From Various Primary Sources Including Shipping Price Indices Obtained From Shipping Trade Journals (Hummels, 2001); According To The General Data In Section 1.4 Of Feilong Case,

Fret1 = $2010
PFOB Shanghai = $4560

FOR N = 1, we have Fret1 = 44% PFOB

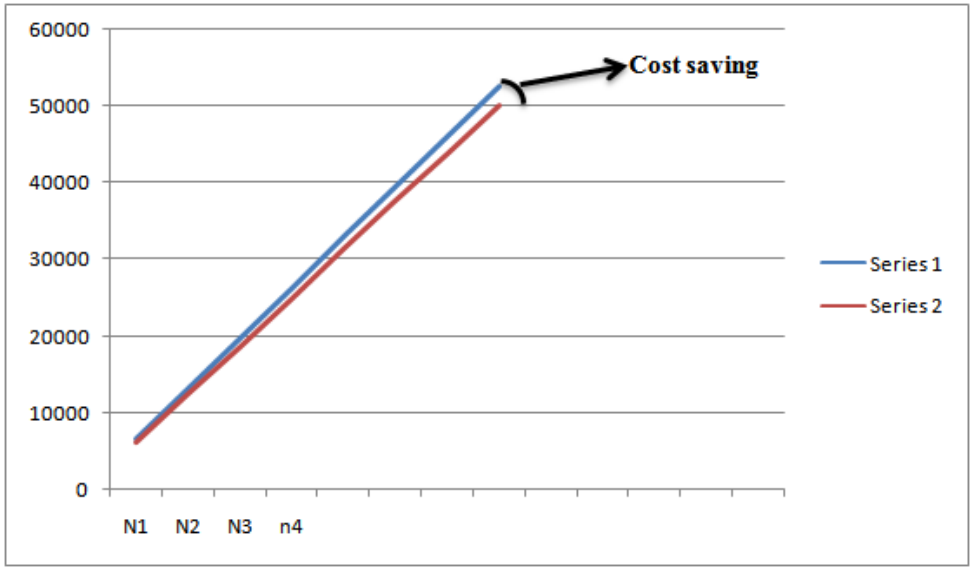
Also

Fret2 = $800
PFOB Tangier = $5472

FOR N = 1, we have Fret2 = 14% PFOB

The Transportation Cost Without Taking Into Consideration The Tariffs Represents 44% Of The Price Of The Product Made In China, Whereas It Represents Only 14% For The Product Made Inother Emerging Market "Morocco".

Fig1- Transport effect



According To The Chart (See Fig1) The Cost Saving Is Increasing With The Augmentation Of Number Of Containers. Which Means When Feilong Factory Produces More Output, It Achieves More Saves If Its Plant Is Located In Morocco

IV. Tariff Effect

When Buying Goods Outside The European Union And Morocco (FTA), The Importers Must Pay Customs Duties And Of Course VAT. Customs Duties Are Calculated From The CIF Value (Value Includes The Purchase Cost, Insurance And Transportation To Destination).The Tax Must Be Paid By The Person Designated As The Recipient Of Real Property On The Import Declaration. However, This Tax Is Payable Jointly By The Declarant Acting.China Doesn't Have Any FTA With European Countries; Therefore Products Made In China Are Subject To Tariff, Here Below The Calculation Of Tariff For Washing Machine:

(1) PCFR Lehaver1 = (PFOB Shanghai+ Fret1),

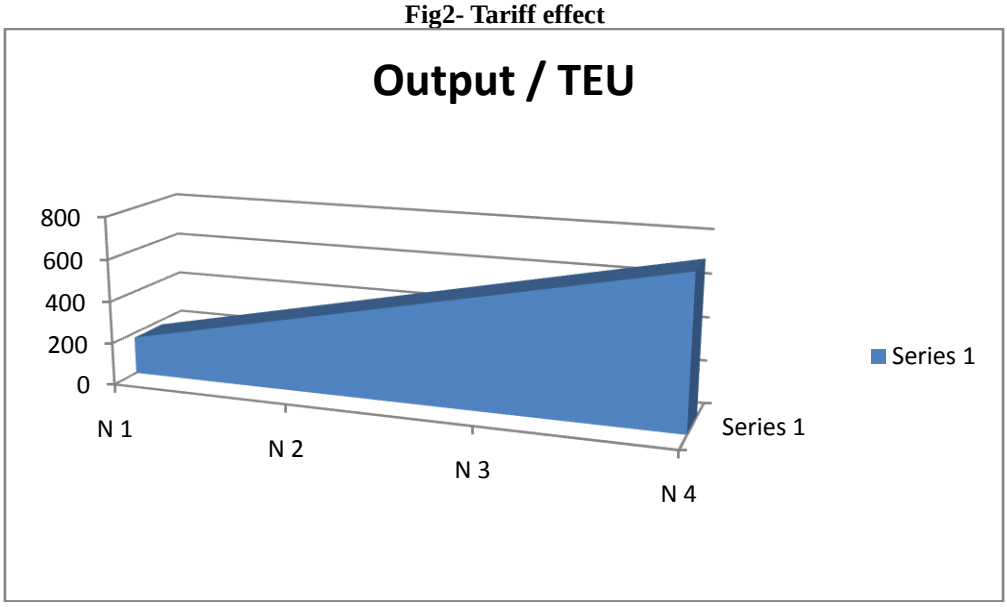
Knowing That PFOB Shanghai = (4560 + 2010), Then PCFR Lehaver1 = $6570

(2) For N=1, Tariffs = Rate (%) X PCFR Lehaver1 = 0.027 * 6570 = USD 177.39

As Result, If The Quantity Imported From China Is One TEU, Then The Extra Cost Will Be $177.39

In Order To Illustrate The Effect Of Transportation In Relation With The Quantity, The Figure2 Shows The Variation Of Tariffs Per Quantity

Fig2- Tariff effect

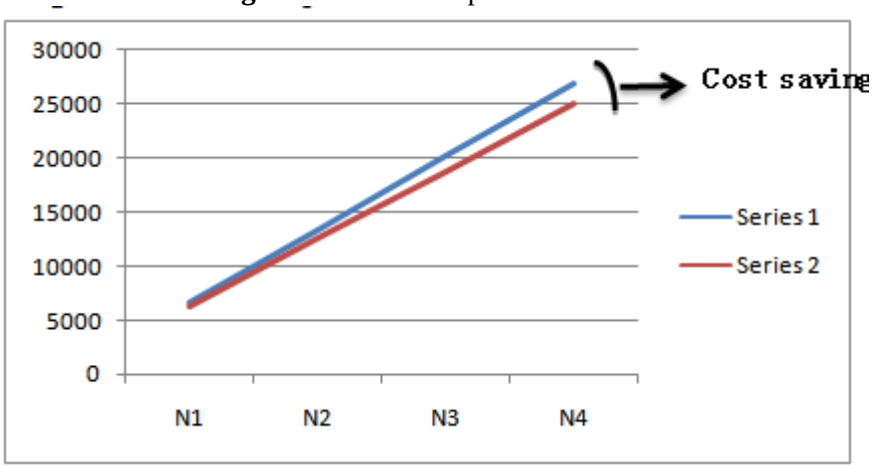


According To The Above Chart (See Figure2), The Increasing Of The Quantity Ordered Entails Subsequently The Increasing Of The Cost. For Instance If The Quantity Exported From China Is 4*20GP Containers Then The Cost Will Rise By $709. In Other Word If China Had A FTA With The European Countries, Then USD 700 Will Be Considered As Saving For Feilongcompany.

3.1. Tariff And Transportation Effect

(1) GP1= N * **{** (TR * PCIF Lehaver1) + PCIF Lehaver1 **}**
GP1 = N * (177.39 + 6560) = N*6737.39
(2) GP2 = N * PCIF Lehaver2
GP2 = N*(5472 + 800) = N*6272
The Results Of These Calculations Will Be Transformed In Graph, In Order To Narrow The Effect

Fig3- Tariff and transportation effect

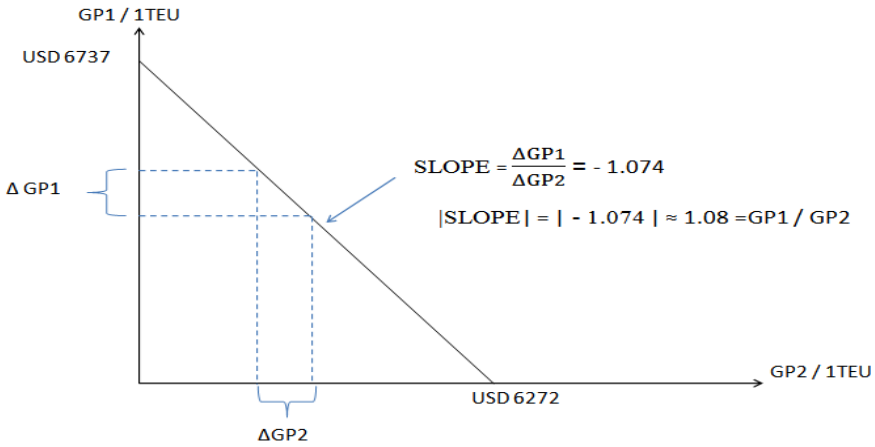


According To Figure 3 The Cost Has Been Enlarged Compared To The Figure 1, As The Tariff Has Been Auditioned In This Time, Which Shows That After Adding Transport And Tariff Cost The Overall Product Cost Reduces Gradually In Other Emerging Market "Morocco" And We Consider This Solution As Beneficial For Feilong Company To Increase Its Market Share In Europe

3.2 Cost Line After Adding Tariff And Transportation

Giving The Last Result (See Figure3), We Can Also Illustrate The Notion Of Relative Costs Graphically. On The Vertical Axis We Measure The Gross Value For The Total Order Coming From China After Adding The Tariff For One 20 Feet Container. On The Horizontal Axis We Measure The Gross Value For The Total Order Coming From Morocco For One 20 Feet Container.

Fig4- Cost line



The Relation On The Graph Shows Us All The Possible Combinations Of The Two Costs That FEILONG Manufacturer Can Have With A Fixed Budget. For Instance If It Produces 10 Containers Of Washing Machine In China And Export Them To France, With The Same Budget FEILONG Can Produce Approximately 11 Containers In Morocco And Export Them To France.

As Result, Instead Of Producing 10 Container In China With The Cost Of USD 67 370, The Factory Can Produce 10 Containers In Morocco With The Cost Of USD 62 720, In Other Word There Will Be At Least A Cost Saving Of USD 4 650.

V. Currency Effect

Currency Effect Plays A Major Role In Finance Field, Dooley And Al (2004) Analyze The Level Of The Chinese Yuan As A Consequence Of The Choice Of The Chinese Government And The Advent Of A "Second Bretton Woods". Faced With A Large Mass Of Underemployed Workers (Estimated At 200 Million By Garber, 2004), The Chinese Government Chose A Strategy Of Exchange Rates To Gradually Integrate These Workers In The Modern Productive Sector. China Has Abundant Savings (Businesses And Households), But As Shown By The Accumulation Of Bad Loans, The Financial System Does Not Ensure A Satisfactory Financial Intermediation. China Therefore Chooses A Low Exchange Rate To Increase Global Demand For Chinese Products, Competitive Effect And To Attract FDI To Finance Its Production And Catch Technological And Managerial Delay. The Low Level Of Real Wages And The Exchange Rate Against The Dollar Provide Foreign Investors High And Stable Yields, Measured In Dollars.(Antoine Bouveret, Sana Mestiri And Henri Sterdyniak, 2006).

The Level Of The Chinese Yuan Against The Dollar Is Not An Indicator Of Economic Imbalances But A Balance Vector For China And To A Lesser Extent For The U.S. (Dooley And Al, 2004)

However Other Authors Thought That FDI Plays Only A Minor Role In China's Growth, And The BW2 System Is Very Expensive For The BOC (Which Runs The Risk Of Its Foreign Exchange Reserves To Depreciate Sharply) That U.S. Firms Producing In China Are Not Making Exceptional Profits, They Do Not Play The Role Of Lobby In The United States, The Chinese Foreign Exchange Reserves Are Not A Guarantee For Them. In Other Word, They Believe That China May Abandon Its Current Specific Strategy Without Losing Much Growth. They Believe That The System Is Not Sustainable For Long Term Because The PCB Will Not Accept To Continuously Accumulate Reserves With Risky Value. (Goldstein And Lardy (2005)).Concretely The Weakness Of The Yuan Is Reflected In A Monetary Advantage Very Pronounced. Beyond Labour Costs Very Low, The Undervaluation Of RMB Lowers The Prices Internationally Of Products Made In China, Allowing The PRC To Produce In Abundance In The Global Market, This Price Competitiveness Has Pushed China To Stand At Top Of Podium Of The Best Exporting Countries In The World.

However The Pressure Made By G20 Members Especially The US Has Pushed Us To Ask Many Questions Such As; Will China Respond To The US Demand ? Will The Appreciation Of RMB Resolve The Global Economy's Issue? In Fact This Current Topic Will Certainly Participate In The Future Perspective Of The International Economy. But For Sure China Has Responded To US Pressure (See Figure 5) As The Yuan Has Been Appreciated Since 2005. In Order To Illustrate The Effect Of The Appreciation Of The Chinese Yuan In Our Previous Calculations, We Will Take Into Consideration The Exchange Rate Of MAD And CNY Per USD.

The Figure 5 Shows The Variation Of The Exchange Rate Of MAD. EUR And CNY, Compared To USD, The Yellow, Blue And Red Line Represent Respectively The EUR, MAD And CNY.

Fig 5- Currency variation

Source: Google finance 2011

According To The Figure 5The Dirham's Trajectory Depends On The Euro Given That It Is Pegged To A Basket Of Currencies With A Heavy Euro Weighting, And The Average Ratio Between MAD And EURO Is Most Of Time 9% (MAD/EURO). The Situation Of MAD Is Not Steady But Insurant For The Manufacturer Process Compared To CNY. In Addition We Know The Reasons Of Variation That Are Related To The Economic Effect Such As The International Crisis. Therefore During The Previous 5 Years The MAD Has Reached Its Maximum Valuation In 2008 (+15%) And Its Maximum Devaluation Twice In 2005 And 2010 (-6%). However The Trajectory Of The Chinese Yuan Is Taking Continuously A Downward Compared To USD Steading At 20% In The End Of 2010.

In Order To Take Into Account The Currency Effect We Will Forecast For The Coming 5 Years That The Variation Of MAD And CNY Will Recognize The Same Scenario, Which Means The CNY Will Appreciate By 20% Compared To USD At The End Of 2020. Therefore The Gross Value For The Total Order Coming From China After Adding The Tariff Will Be As Follow:

GP1 (2020) = {GP1 (2010) + (20% * GP1 (2010))}
GP1 (2020) = 1.2 * GP1 (2010)
GP1 (2020) = 1.2 * $6737 * N
GP1 (2020) = $8084 * N

However For The Case Of MAD, There Will Be Two Probabilities As The Interval Of MAD Variation Is From -6% To +15%.

1st Probability: MAD Will Reach At The End Of 2020 Its Maximum Appreciation +15%
2nd Probability: MAD Will Reach At The End Of 2020 Its Maximum Depreciation -6%

In The Aim Of Making Our Comparative Study Accordingly More Solid, We Will Suppose The Following Assumptions For All Cases:

Assumption1: The Increasing Prices Of Raw Materials And Other Determinant Factors Will Be Ignored
Assumption2: No Free Trade Agreement Between China And EU Will Take Effect

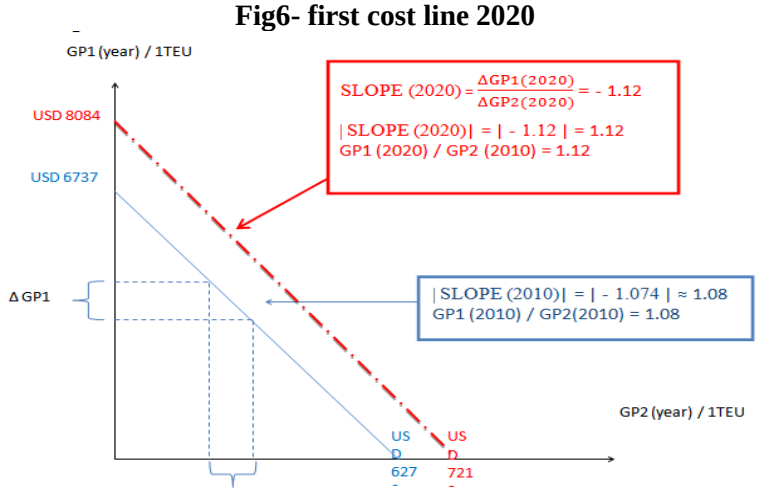
4.1 Currency Effect For The 1st Probability

In The Current Probability The Gross Value For The Total Order Coming From Morocco Will Be As Follow:

GP2 (2020) = {GP2 (2010) + (15% * GP2 (2010))}
GP2 (2020) = 1.15 * GP2 (2010)
GP2 (2020) = 1.15 * $6272 * N
GP2 (2020) = $7212 * N

Given That GP1 (2020) = $8084 * N, Then GP1 (2020) Is Still Greater Than GP2 (2020). And The Slope Has Been Indeed Enlarged Compared To The Previous Result (See Figure 4); Therefore We Will Again Illustrate The Result Graphically. On The Vertical Axis We Measure The Gross Value For The Total Order Coming From China At The End Of 2020 After Adding The Tariff For One 20 Feet Container. On The Horizontal Axis We Measure The Gross Value For The Total Order Coming From Morocco For One 20 Feet Container.

Fig6- first cost line 2020



The Relation On The Graph Shows Us That The Slope At The End Of 2020 Has Been Augmented By Around 4% Compared To The Year 2010. As Result The Possible Combination Of The Two Costs That FEILONG Manufacturer Can Has With A Fixed Budget Of USD 67 370 Is As Follow:

In 2020, Instead Of Producing A Given Amount In China With The Cost Of $67370, The Factory Can Produce The Same Amount In Morocco With The Cost Of $60152, In Other Word There Will Be This Time At Least A Cost Saving Of $7218, Whereas The Cost Saving In 2010 Was Just $4650

As Conclusion Currency For This Probability Impacts Significantly For Widening The Difference Of Product Cost Between Morocco And China, It Becomes More Profitable To Produce In Morocco Than In China

4.2 Currency Effect For The 2nd Probability

In The Current Probability The Gross Value For The Total Order Coming From Morocco Will Be As Follow:

GP2 (2020) = {GP2 (2010) - (6% * GP2 (2010))}

GP2 (2020) = 0.94 * GP2 (2010)

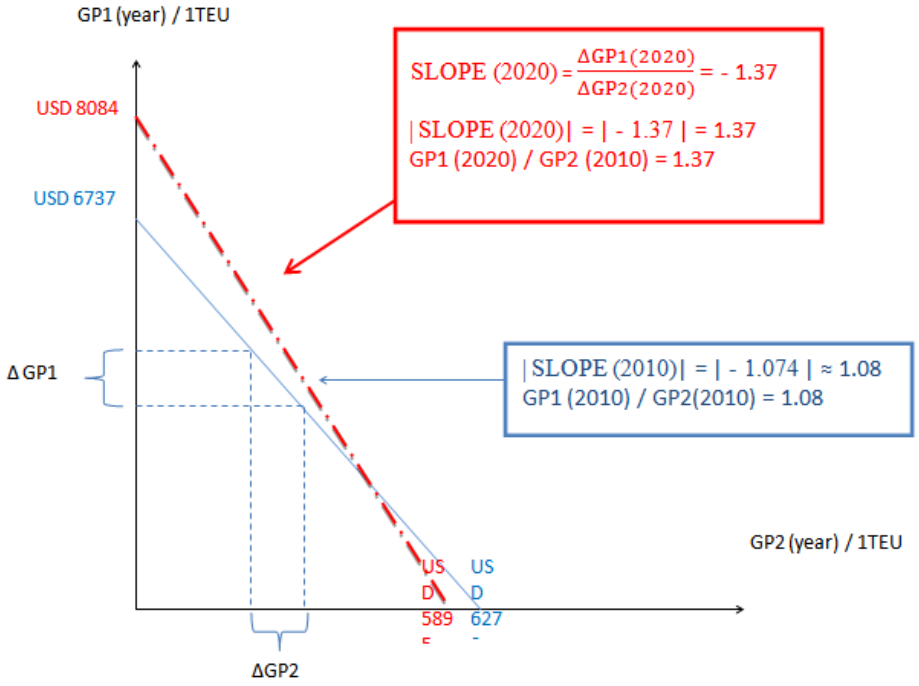
GP2 (2020) = 0.94 * $6272 * N

GP2 (2020) = $5895 * N

Given That GP1 (2020) = $8084 * N, Then GP1 (2020) Is Still Greater Than GP2 (2020). And The Slope Has Been More Enlarged Compared To The Previous Results (See Figure 4 And Figure 6); Therefore We Will For The Third Time Illustrate The Result Graphically.

On The Vertical Axis We Measure The Gross Value For The Total Order Coming From China At The End Of 2020 After Adding The Tariff For One 20 Feet Container. On The Horizontal Axis We Measure The Gross Value For The Total Order Coming From Morocco For One 20 Feet Container.

Fig7-Second cost line 2020



The Relation On The Graph Indicates That The Slope At The End Of 2020 Has Been Raised By 27% Compared To The Year 2010, Much Greater Than The Augmentation In The 1st Probability (See Figure 6). As Result The Possible Combination Of The Two Costs That FEILONG Manufacturer Can Have With A Fixed Budget Of USD 67 370 Is As Follow:

In 2020, Instead Of Producing A Given Amount In China With The Cost Of USD 67 370, The Factory Can Produce The Same Amount In Morocco With The Cost Of USD 49 175, In Other Word There Will Be In This 2nd Probability A Noteworthy Cost Saving Of USD 18 194 (37% Of Saving), Whereas The Cost Saving In 2010 Was Just USD 4 650.

As Conclusion Currency For This Probability Impacts Significantly For Widening The Difference Of Product Cost Between Morocco And China, It Becomes More Profitable To Launch The Production In Morocco Than In China

VI. Conclusion

Transport Cost, Tariff And Currency Forecasts, These Overall Determinants Factors Are Not On The Chinese Side, They Indeed Worsen Its Competitive Standing Toward The New Emerging Markets; Although The Chinese Currency Is Increasingly Appreciating With Remarkable Pace, But G8 Members Are Not Satisfied,

They Are Pushing Aggressively The PRC To Appreciate Its Currency To A Greater Extent. For That Reason Chinese Companies Having Some Difficulties In Seeing Their Profits Moving Forward Due To Their Competitiveness Disadvantage Should Put A Foothold In Closer Attractive Emergent Markets To EU Such As Morocco For Keeping Theirs Prosperous Growth And Makingsignificant Cost Saving. To Conclude Researchfeilong ELECTRICAL APPLIANCE CO., LTD Should Opts For Investing In Morocco In Order To Expand Geographically And Subsequently Gain New Markets And Reinforce Its Competitive Standing.

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