

Running a business on an international scale requires not only a substantial body of knowledge but also the ability to apply it in practice. That is why our textbook, with a vast collection of practical examples, discusses a wide variety of pertinent issues connected with business operations in international markets, from international market analysis, drafting business plans, concluding business transactions and the insurance of goods through to customs clearance procedures and professional etiquette. We also explain the specificity of doing business online.

The book is addressed primarily to students of courses in economics and management. We hope it will also make interesting reading for entrepreneurs and people indirectly involved in international business, who work in its immediate environment in banks, chambers of commerce and consulting companies and those who have dealings with public administration at different levels in foreign countries.



Project: The creation of new interdisciplinary curricula in the field of economics of environmental protection (in Polish and English) at the University of Łódź. Project supported by a grant from Norway through the Norway Grants and co-financed by the Polish funds.

The aim of the project is to improve the knowledge and awareness of Polish and foreign students, the faculty and alumni of the University of Łódź in the fields of sustainable development, ecology, international business and finance.

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PRACTICAL ASPECTS IN DOING INTERNATIONAL BUSINESS



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editors  
Tomasz Dorożyński  
Janusz Świerkocki



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IN DOING  
INTERNATIONAL  
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WYDAWNICTWO  
UNIwersytetu  
ŁÓDZKIEGO

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## PREFACE

The textbook *Practical Aspects in Doing International Business* is addressed primarily to Polish and foreign students of courses in economics and management, who wish to get acquainted with the basics of doing international business, be it exports, imports or direct investment. The rules guiding international operations differ from those in the domestic market due to the diverse legal, political, economic systems and culture, but also because of the different levels of economic development in individual countries. Hence, the textbook targets those who will work in small and medium-sized enterprises interested in internationalisation, in multinational enterprises, in business environment institutions indirectly involved in international business, such as banks, chambers of commerce and consulting firms, as well as future civil servants employed at different levels of public administration and involved in international relations.

The idea of the authors was to prepare a textbook for those who have already acquired the foundations of international economics and are familiar with the theories of international trade, foreign direct investment, processes in international economy, trade policy instruments as well as exchange rate and foreign exchange market mechanisms. Up to date and orderly knowledge in these areas reduces the risk when making decisions that go beyond the domestic market and enhances the chances for success abroad.

Doing international business effectively surely requires general knowledge but also the ability to apply it in a practical economic framework. That is why we draw attention to those aspects which, in our opinion, have been missing in the publishing market in Poland. We make little reference to theory as our intention was to present, in a concise form, only practical issues with as many real-life examples as possible.

The book is the result of a project which involved the authors who are research staff of the Department of International Trade of the University of Lodz<sup>1</sup>. Due to the limitations imposed by the project, we had to

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<sup>1</sup> The project „The creation of new interdisciplinary curricula in the field of economics of environmental protection (in Polish and English) at the University of Łódź” implemented in the years 2015–2016 and supported by a grant from Norway through the Norway Grants and co-financed by the Polish funds.

select and discuss issues that we considered the most pertinent for future entrepreneurs.

The first chapter discusses the basic rules of etiquette, both professional and non-business. Our point of departure was that, in any area, social competencies are important as they go hand in hand with analytical and managerial skills. These competencies include, inter alia, propriety, communication in writing, building relationships with others and intercultural awareness (Filipowicz 2004). The high level of these competencies is decisive for the success of tasks that require entering into various forms of relations with other people.

Business success, in particular in international markets, depends on how fast quality decisions are taken, which depends on the management pattern and access to information about the economic environment. To be able to operate effectively, we need to correctly diagnose the enterprise's performance and its market position. That is why in the second chapter we draw attention to the use, structure and drafting of business plans while the third chapter presents the scope, stages and methods of international market analysis.

Chapters four, five and six explore the most frequent forms of business internationalisation, their legal circumstances and types of international transactions, how they are prepared, concluded and executed. Special attention is paid to the settlements of liabilities, the insurance of goods and customs clearance, in particular in trade between EU Member States and third countries.

Chapter seven discusses the specificity of doing business online. Operating as an e-business calls for adjusting the strategy to rules and conditions which are different from those in traditional business. That implies challenges and opens up opportunities, which is why increasingly more businesses feel the need to be present online. We have explained the substance of the so called "new" economy, put in order and discussed the key terms connected with e-business, we have also specified the role and importance of the Internet in business operations and we have outlined the most important e-business models.

We would like to gratefully acknowledge the effort and valuable comments of the reviewer, Dr hab. Krystyna Żołądkiewicz, Professor of the University of Gdansk, and thank the experts in the project, Dr hab. Mirosław Jaroński, Professor of the Warsaw School of Economics, and Dr. Edward Karasiński, from the Lodz Society of Science. Obviously, all the remaining shortcomings and errors are attributable solely to the authors.

# Chapter 1

## Business etiquette

Janusz Świerkocki

“Courtesy is not a science too easy or small”.

A. Mickiewicz, *Pan Tadeusz*

### 1.1. What is etiquette and why do you need to know and observe it?

The word “etiquette” in the context of this discussion means “the rules of behaviour standard in polite society” (The New Lexicon 1988, p. 325). Commonly, etiquette is interpreted as good manners, which may apply to various social settings with the business setting being one of the most important. The latter is also an ambiguous term that for the needs of further considerations will be understood as a “workplace”, within which, and in relation to which, we establish relationships with other actors of economic transactions. It may be an enterprise, an office or a law firm, but also a public institution, research centre or university. The staff and clients of all these establishments should exhibit good manners.

By following etiquette, we show respect to others. Such an attitude serves well the interests of employers and employees as, on the one hand, it is relevant for the smooth operation of each and every institution and, on the other hand, it facilitates a successful professional career. Firstly, mutual respect favours a good organisational atmosphere which is vital for the commitment of employees, their honesty, proper time management and identification with the firm, etc. Such attitudes impact reasonable use of the raw materials, materials, machinery and knowledge that the organisation possesses. The good manners of the employees may attract clients more easily and encourage them to stay instead of choosing competitors. Consequently, the market position of an organisation gets

reinforced. Secondly, practising etiquette boosts your self-confidence. When you know how to behave in a particular setting, you are more relaxed and can better focus on substantive issues. Thirdly, observing etiquette is a way to be respectful and trustful in the eyes of other people, which helps in professional development although, obviously, we must remember that having good manners does not necessarily go hand in hand with professionalism and high moral standards.

According to sociologists, good manners belong to *social norms* while economists categorise them as *informal institutions*. They originate from tradition, culture and customs and are neither codified nor written down. Manners provide a code of conduct and tell us what to do and what not to do in various social settings. Usually, they concur with the norms that regulate the lives of individual communities (legal, moral) but sometimes they contradict them. For example, while legal and moral norms impose the duty of truth telling, a comment addressed to a co-worker who takes little care of their personal hygiene may be a reason for a decline in mutual relations. Not observing etiquette often means committing *faux pas*. Although that itself does not imply legal sanctions, sometimes not even reprehension by others, the act may have unpleasant consequences, such as critical remarks, being ridiculed, embarrassed or looked down on by colleagues. That is why one should not ignore or disregard etiquette.

Due to their origin, good manners are general or universal only to a very limited extent. In most cases their scope is limited by place, time and social environment. Discussing them all would be a near to impossible task<sup>1</sup>. Punctuality, for example, is understood differently in countries of Latin America and in Anglo-Saxon countries; a visiting card was once used when paying visits while nowadays it does not perform this role anymore; addressing others by their first names is natural among students, but less popular among slightly older people. These rules evolve. Dress codes have become more flexible in recent years. Technical progress has also brought new rules, like those connected with using mobile phones or e-mails.

Considering the above circumstances, one may say that, firstly, we should be flexible in our approach to good manners and show understanding for cultural differences; and secondly, it is simply impossible to learn business etiquette in full. In fact, both comments are correct. Nevertheless, one should at least try to learn as many rules as possible,

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<sup>1</sup> Due to limited space, we shall limit ourselves to some of the most important norms approved of in Poland and in Western culture.

which will facilitate making a good impression in dealings with business partners. It is especially true when meeting people from other countries. One should also bear in mind that changes and new phenomena are true of the forms rather than of the building blocks of etiquette. The latter are stable and can be best illustrated by the old Polish saying "do as you would be done by".

## 1.2. Greeting someone and saying hello. Saying goodbye

Greeting someone and saying hello are the first opportunity for personal contact which makes a lasting impression on interlocutors, often decisive for further relations between the parties involved. When meeting people you already know, both are usually automatic, you do not analyse why they take one form or another. But when it comes to people you do not know, the issue requires a little more attention and taking account of various circumstances.

Greetings come in two forms: verbal, which is mandatory, and non-verbal, which does not always accompany the first one. There are some differences between the two which are worth highlighting to avoid misunderstandings. They are connected with the principle of precedence.

**The verbal part of a greeting** is a greeting phrase. It may take various forms. If you know the other person sufficiently well, you may say, e.g., "Hello". In other cases you usually say "Good morning (Good afternoon, Good evening)". If you want to sound more polite, you may personalise the greeting by saying, e.g., "Good morning, Madam", "Good morning, Doctor", "Good Morning Madam Director", etc. In some languages (French, English) you may also add the person's last name, but in Polish culture addressing someone by saying "Good morning Mr. X" is not in good taste and may be considered offensive.

**Etiquette strictly requires us to greet people we know and respond to greetings of others without any exception.** When it comes to precedence, in accordance with the principle universally acknowledged in everyday life, the relationship of the status of the two people, referred to as **seniority** in etiquette, decides. The person of lower status always greets first, i.e. a man greets a woman; a younger person greets an older person; a student greets a professor, etc. Things get more complicated when the dividing lines are not exclusive and a younger woman meets an older man. In business, the principle is easier, **precedence is based on hierarchy**, i.e., sex or age are irrelevant. Thus, a female employee should

greet her superior first and a shop-assistant should greet her/his client independently of how old they are. However, also in these cases some doubts may arise, especially when age differences are substantial, e.g., a woman who is a shop assistant who is much older than her male client. All these complexities should be dispelled by the use of common sense: there is nothing wrong in a superior greeting his employees first. This is one of the cases to which an old principle applies, according to which the more polite of the two says "Good morning" first.

It may also happen that a particular setting takes precedence over seniority. And thus:

- people inside a room (conference room, class-room, waiting room, reception, on-call room, lift, etc.) should no doubt be greeted by those who enter;
- people who are standing (in the corridor, on the pavement, etc.) should be greeted by those who are walking (riding).

**A non-verbal element of greeting** is, depending on the circumstances, a bow, a nod, tipping a hat, a kiss but most often a handshake. And the precedence here is the reverse to the one for verbal greetings. Customarily, a woman extends her hand first to a man, an older person to a younger, a professor to a student, etc. A similar sequence applies to saying goodbye. However, in business settings, the rules are suspended, making room for hierarchy. Hence, it is appropriate when a younger director extends his hand to an older employee or to a female receptionist. When ranks are equal, it does not matter who does it first, the man or the woman (but a host should do it first to a guest). Unlike when saying hello, in doubtful situations, especially at the beginning of an acquaintance, it is worth remaining slightly reserved and not extending a hand first.

Extending a hand in itself is almost instinctive and we do not always pay attention to how we do it. Hence, we should, first and foremost, remember that:

- the palm must be clean and dry (something to be remembered, e.g., when you are holding a glass with cold drink at a party, as the hand gets damp);
- when extending the hand, you should briefly make eye contact with the other person (in some cultures, e.g. in Japan, this is not practised).

Depending on the circumstances, it is nice to include a pleasantry (e.g., when we have not seen each other for a longer period or this is the first meeting ever);

- the palm should be held perpendicular to the floor (some people, women in particular, extend the hand parallel, "covering" the palm of the partner);
- you do not want to offer a limp hand "to be held", but you offer a firm grip, not overpowering and not too long;
- the refusal of a handshake is a serious insult to the other person;
- in the workplace, you do not have to shake hands every day but you should do it after, e.g., a longer period away.

To finish the subject of saying hello, it is necessary to comment on hand-kissing. This custom, still alive in Poland and also practised in, e.g., France, provokes no embarrassment in private relationships but it does not fit business and official contacts although some women tend to extend their hands in a way suggesting that they simply expect the gesture from the man. Thus, remember that in official relations:

- if you want to practise this form of courtesy, you should kiss the hands of all women at a particular gathering, not only some of them (depending on the age, position, appearance or any other criteria);
- you should not do it in a hurry, mechanically, by dragging the hand up to your lips (which, as we can sometimes see on TV, some politicians do) but you should bow a little;
- the custom does not match situations such as receiving awards, diplomas, nominations and also, as once playfully observed by Ambassador Pietkiewicz, fines for the infringement of traffic rules (Pietkiewicz 1998 p. 103).

Saying goodbye, similarly to saying hello, may also consist of two parts: verbal and non-verbal. The only difference being that it is initiated by the person in the higher position of authority (someone older, a superior, a woman) by saying, e.g., "Goodbye" and possibly extending a hand.



### 1.3. Introducing people

In private life, and almost everywhere in work-related situations, we regularly meet new people and establish relations with some of them that are continued for a longer or shorter period of time. In accordance with etiquette, an acquaintance starts with an introduction. It is customary to be introduced by a third person, e.g., by the host (or hostess) of the meeting or someone who knows both sides; you may also introduce yourself.

If you are the intermediary, you need to pay attention to the following circumstances. First, you need to find out who you are introducing to whom. **In social relations** we follow the same order as when saying hello, i.e. a younger person is introduced to the older, a man to a woman and an employee to a superior. Similarly, **in business relations**, precedence in introductions is not based on age or sex but on the position in the hierarchy and, as always, on common sense. Secondly, it is polite to give not just their names but also where they work and their positions (also scientific degrees or titles). If memory fails you, which may happen to anyone, you must subtly overcome the problem, which is a challenge requiring a combination of finesse and a sense of humour. Thirdly, the rule is that we introduce a newly arrived person to those already present, with the exception of a situation when the newly arrived person clearly dominates when it comes to her/his position. Fourthly, following the introduction and a handshake, you should also exchange pleasantries while the initiative to have a conversation rests entirely with the person in the higher position of authority.

If at a particular meeting you may not count on anybody's assistance, it is always polite to introduce yourself, remembering the principle of seniority. The only difference is that when giving your first and last names, and possibly the name of the organisation which you represent, you never give your position or scientific degrees or titles. These details may be revealed later in the course of conversation.

### 1.4. Visiting cards

Usually when meeting someone in a business situation we exchange visiting cards, commonly referred to as business cards. They were invented in the 15<sup>th</sup> century by the Chinese, still before the invention of print, and then they reached Europe. Nowadays, in classic form, they are paper

cards **the size of a credit card** which give the bearer's personal data. The cards spread globally and still survive in the times of the e-economy, which is remarkable. Despite some attempts, they have not been successfully replaced with any kind of digital business cards (The Economist 2015).

There is a variety of cards in use: business, private individual and private collective (for married couples). In this section we shall focus on the first type.

The layout and design of a business card for an organisation is decided by the top management and an employee has no impact on it. In real life we can come across all sorts of ideas, not all of which are practical (especially when it comes to size) or in good taste. Simplicity is highly recommended.

As we have already mentioned, **a classic card should be of the size 5 cm x 9 cm**. The reason behind this is simple: this is the size of most business card holders, where you store them. Preferably of high quality white card, it should include the logo of the organisation, the first and last names, position (possibly scientific degree or title), business address (mail, e-mail, fax), and telephone numbers for contacting the bearer. Top managers usually give the telephone numbers of their secretaries, not their direct phone numbers. Information should be arranged in a clear and easy to read manner, which depends, inter alia, on font face and size. You do not have your private telephone number or address printed on a business card. If necessary, any additional contact data can be hand-written on it or you may use your private card.

The most often committed mistakes when designing business card layouts include:

- using bilingual cards where, e.g., on one side the text is in Polish and on the other in English. The back of the card should be left unprinted. Etiquette admits "translated" cards only when we are dealing with a language with a little known alphabet (e.g. Chinese);
- making the card unusual, e.g., by laminating it, using a different format, including the holder's photo, mottos, sayings, etc.;
- giving the address in a foreign language instead of Polish, e.g., *Warsaw* instead *Warszawa*, *Rewolucji St.* instead *ul. Rewolucji*;
- not clear layout due to too many details, fancy font face or too many colours.

Visiting cards were used when paying unexpected visits (hence the name). Leaving a visiting card at someone's home with its corner folded (upper left-hand) was a clear sign of paying a visit. Nowadays, **a visiting card is used to quickly establish and maintain contacts**. It reminds you that you have met the person in real life rather than over the Internet but also, by informing us about the position of the individual, it highlights the importance of hierarchy in business life. The card is also used for **correspondence purposes**. We may attach it to a bunch of flowers or any other gift when expressing our gratitude for a party, assistance, wishes, etc., with the message written in the first person and on the reverse (this is one of the reasons why it should be left unprinted).

**Using business cards is a vital business ritual.** First of all, you should have them in sufficient numbers to avoid apologizing to your interlocutors for why you do not have one. That would only show your poor preparation for the meeting. Cards should be carried in business card holders, special little wallets or cases, rather than in bags and pockets. That helps to avoid creasing and getting them dirty. Business card holders are also used to store business cards you have received. The business card should be handed over to an interlocutor in a way that enables her/him to read your data immediately. Upon receiving a business card, you are expected to read it and then put into the holder. Never ever fiddle with the card you have received. Business cards are presented and received with one hand but in some countries (China, Japan) they use both hands and bow a little. This is a way of showing respect to the other person, since the card is a part of their identity.

Business cards are exchanged according to the circumstances. When a client comes to your office, business cards are exchanged at the beginning of the meeting. If the meeting is attended by a bigger group of people, everybody can put their cards on the table in front of her/him so that names and positions could be better memorised, which improves the overall atmosphere of the meeting and future business contacts. When taking part in a conference or a party, business cards are exchanged at the end of the conversation as a sign that we wish to continue the newly established relation. If this is a seated event, the exchange of business cards must be postponed until you leave the table.

In business situations, the sequence in which cards are exchanged is the same as for shaking hands. Seniority is decisive, i.e., it is initiated by the person in the higher position of authority; in private settings also,

it should be the one who is older or a woman. When in doubt, a person at a lower level of hierarchy ladder should be more reserved and refrain from handing in his/her card.

### 1.5. Having a conversation

In Polish culture, a face to face conversation that gives an opportunity to look the other person in the eye is the most direct form of communication, possibly the most fundamental for building trust not only in professional relationships<sup>2</sup>. That is why now we shall focus on having a conversation, which is a daily activity carried out without realising its importance or considering its course when we have them when taking care of the business of our organisation.

When business partners meet, the main topic for discussion is usually preceded by so called *small talk*, meaning a brief conversation “about everything and nothing”, to build up a good atmosphere and positive feelings. The same sort of conversation accompanies most social meetings. It has got nothing to do with business. Its subject should not be controversial or relate to politics, religion or ideology. The same is true of anecdotes or jokes. Caution is also required when touching upon issues that imply some judgement, e.g., artistic or sports events, books, films, or other people’s behaviour, as they may provoke unexpected objection of the interlocutor when formulated in a harsh way. Similarly, one should not expect an interlocutor who turns out to be a doctor to diagnose health problems. The list of relatively safe topics includes holiday plans, traveller’s impressions, culinary experiences, and weather. Of course, we should not restrict ourselves just to them but an intelligent, educated and cultured person can surely continue an already started conversation.

We need two parties to have a conversation, as it is supposed to be **a dialogue rather than a monologue**. When you talk you should also let other people do the same. That is dictated by good manners and it gives an opportunity to win the sympathy of the interlocutor, as many people like talking and they feel more important when somebody listens to them. While listening, you should not interrupt but you must show interest in the issue by looking the other person in the eye, asking a question, nodding, etc.

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<sup>2</sup> In Japan or Korea, looking the other person in the eye during conversation is not accepted, especially when the person is older or has a higher social position.

While talking, use a friendly tone, do not make energetic gestures, avoid colloquial, not to mention vulgar, language and do not throw in foreign words or phrases, as that might embarrass the interlocutor who might not know them. If you do not agree with her/him, you do not protest by saying "you are wrong" but you can object more mildly, e.g., "your opinion is interesting, however...". To show respect, using titles is recommended when addressing other people (in female and male versions), especially when the seniority gap is substantial. Titles are linked to the position in a hierarchy and military grades (e.g., president, minister, director, colonel), scientific achievements (doctor, professor) or are a matter of courtesy (e.g. excellence, eminence, magnificence). Good manners tell us to call a deputy-minister a minister. The most important thing, however, is a nice smile when addressing the interlocutor.

Besides face-to-face meetings, we often talk on the phone or over the Internet to make a lot of arrangements. In accordance with the advertisement of one of the US telecommunication companies, a phone call is *the next best thing to being there*. Mobile telephony has enabled us to contact people practically anywhere. Hence, we need to take care **not to disturb others** (e.g., in a cinema, church) and, in our own interests, we should be discreet. We mean here public places and, e.g., in Japan using mobile phones on public transportation and on trains is forbidden. Answering a phone during business meetings is impolite as it implies disrespect to the other party.

When calling people at their private (home) number, you say hello and introduce yourself. Otherwise, if the call is answered by somebody else, he/she may refuse to share any information. If the person is not a good friend of yours, you should not call on business matters between 10 P.M. and 8 A.M. on weekdays, on weekends, at breakfast/lunch/dinner times or when important events (sports events, concerts, etc.) are broadcast.

When calling an institution, it is usually the answering party that introduces itself by giving the name of the organisation, her/his first and last name and offering a greeting. They may say, e.g., *this is XYZ company, John Smith, how can I help you/ what can I do for you?* Then, they either solve the problem themselves or put us in touch with a competent person. The one who is calling must also introduce themselves if they wish to get information or contact the management. **A telephone conversation must be prepared**, as you will probably need details that you wish to explain. Coming back with the same questions makes a bad impression.

## 1.6. Correspondence

Writing letters is an art and often a record of developments, which is why published collections of letters written by personalities from the world of culture or politics are so popular. Skills in writing business letters are by no means a trivial matter. Although technological progress has simplified written communication (by introducing a cable in the past and a text message now), the letter has retained its position, mainly as a means to confirm oral arrangements and as the most formal way to communicate decisions concerning an order, offer, complaint, invitation, etc. For this reason, its form, content and rules governing business correspondence are matters of great care.

**The proper form** is achieved through carefully and precisely composed content and politeness vis-à-vis the addressee. This is a way to win their favour, while by breaking the rules you show disrespect and give the addressee the right to ignore your letter. On top of that, while an unpleasant conversation slowly fades away in memory, a letter stays for longer as a reminder of tactless behaviour and casts a shadow over future relationships.

Each letter must contain basic information (sender, addressee, place, date, the matter that it relates to, attachments). To be easy to read, the body of the text must be divided into paragraphs and aesthetic. Spelling mistakes are unacceptable since they are signs of the carelessness of the author and the organisation they represent. Using bold letters or underlining selected fragments is not recommended as this is a way of indirectly admitting that your message is unclear or that you do not expect much perspicacity from your addressee.

In Poland it is customary to place the addressee's data in the upper right-hand corner. First and last names, possibly the title and position, the name of the organisation and its address are all given in full, without abbreviations (the only exception being *Dr.*). Hence, we do not write *Mr. J. Smith Dir...*

A formal letter starts with the greeting (salutation), which depends on the addressee's position and the relationship between the sender and the addressee. For example, it reads *Dear Mr/Ms*, followed by the title or position, such as *Professor, Barrister, President, Manager*, etc. or *Dear Sir/Madam*. Titles are also used in the body of the text. The letter ends with proper complimentary close, e.g., *(Very) Sincerely yours, Yours truly. Respectfully yours*, quite commonly used by Polish public administration,

is considered impolite and a little inelegant in business correspondence. Both the greeting and the closing are handwritten, preferably with a fountain pen rather than a ball pen. Obviously, the signature is also handwritten and it provides the full name of the sender.

Business stationery should not be creased or dirty and the stamp must not be placed upside down. The text of the letter covers only one side of the sheet.

Sometimes **drafting a business letter correctly is a real challenge**. Firstly, it is not easy to convey the content within several to a dozen sentences. Addressees usually do not want to spend too much time studying long essays. Secondly, facts must be rendered precisely and author's intentions should be reflected faithfully. Differently from a conversation, in this case factual mistakes cannot be corrected: dates and places of meetings, quantity of ordered goods, expert's personal data, etc. Neither is it possible to deploy a gesture, tone of voice or a smile to mitigate the addressee's reaction to the letter if they misunderstand what you really wanted to communicate. Thirdly, letter content should be concrete and close with the sender's expectations regarding the addressee.

**The exchange of letters is governed by specific rules.** The first and the most important one is that business letters must be answered (with the exception of a thank-you letter). Usually, the answer should be given within a week. We must also remember to send Christmas and New Year wishes to maintain relations with business partners, and that not all of them celebrate these as religious festivals, a fact ignored on Polish Christmas cards which tend to show religious themes. It is worth remembering that private letters should be handwritten, similarly to condolences and congratulations.

For business purposes, we increasingly often use **electronic mail** rather than traditional one. It is quicker, cheaper and more convenient. Emails can be exchanged a few times a day and, besides the body of the text, they may include an attachment of almost any type (a book, a photo, architectural design, scan of a document). **Emails are less formal**, and due to the possibilities offered by technical progress, it seems just impossible to work out universal and relatively stable rules with respect to them.

Nevertheless, general comments concerning the form and the content remain unchanged also for electronic correspondence. Its specificity has added some new requirements, such as:

- answer within 24–48 hours at the latest;
- try to be as brief as possible because, due to multitude of emails, people often read only the few first sentences of longer letters and do not pay attention to the information at the end; in general, an email should be shorter than paper business correspondence;
- provide the subject of email in the specially designated field to facilitate further exchange;
- avoid exposing email addresses (names) by listing them all in the *To:* field as that may infringe their privacy;
- ask for receipt confirmation only when you need it, not regularly;
- select the content carefully, as for all sorts of reasons unauthorised persons get much easier access to them than in the case of traditional mail;
- think the content over thoroughly and control emotions: emails reach addressees almost immediately and are irrevocable while traditional letter offers more possibilities to change it or even withdraw it.

### 1.7. Business events and receptions

Receptions are inherent elements of social life. You are invited or you invite others on the occasion of name days, birthdays, weddings but also for no particular reason. Parties bring entertainment into everyday life and are a great opportunity to have a good time with family and friends. In professional life, as in private situations, receptions play a similar role. On top of that, however, they make a part of the business duties performed e.g. behind a table, not behind a desk. Thus, **business receptions can be divided into working and social events**, differently from private parties organised solely for social purposes. Their organisation and pattern are slightly different, which shall be explained below.

**There is a variety of receptions and events that may be organised in relation to formal functions.** They vary in importance. Seated parties, such as lunches, dinners and banquets, rank higher in the hierarchy than standing ones such as cocktail parties, cocktail buffets, aperitifs or a glass of wine. Evening events (dinner) are more important than those organised in the afternoon (lunch). Parties differ with incurred expenses,



which depend on how rich the menu is and how costly the service. Calculating per person, standing receptions are cheaper and lunch usually costs less than dinner. Another reason for differences is the number of participants. With enough space, we may host more people standing than seated at the table. All of the above (importance of the event, cost, available space) should be considered when deciding what kind of event will be organised.

### 1.7.1. Invitations

No matter what format we choose, guests must always be invited. Depending on the circumstances (number of people, importance of the meeting, date), invitations may be extended personally, on the phone or in writing. Forms of invitations may be combined by, e.g., confirming an oral invitation in writing.

An invitation in writing is a letter or, most often, a special invitation card (with the logo of the organisation) where the first and last names of the guest are **handwritten**. For obvious reasons, an invitation must provide two groups of information: (1) who invites, on what occasion, whom and to what (event format); (2) where and when the event will be held (name of the location and detailed address, date and time).

Invitations can be complemented with the following:

- a request to confirm one's attendance included in the R.S.V.P. (*répondez, s'il vous plaît*) abbreviation, usually placed in the lower left- or right-hand corner, together with the telephone number or email address of the organiser. Another option is a note saying *regrets only*, which is a request addressed only to those who are not coming. Knowing how many people are going to come largely facilitates the planning of the event;
- a reminder that the guest has already been invited earlier (e.g. orally). This is why the PM (*pour mémoire*) abbreviation is used;
- the event dress code, e.g., *business suit*, *informal* or *semi-formal dress*, *black tie* (tuxedo), *white tie* (tails). Suggestions are addressed mainly to men since everyone assumes that based on them, women can easily adjust their outfit to the occasion;
- information that it is a personal invitation, which may not be passed on.

When preparing invitations, you should remember that:

- it should reach the guests at least 2 weeks before the event so that they could be available. Late invitation may be considered an affront;
- one invitation can be used to invite no more than two people (e.g. a married couple);
- guest data should be double checked (e.g., have they changed the address, marital status, name) to avoid making a gaffe;
- hosts always “have the honour to invite” not just “invite”;
- for standing receptions, beginning and end hours are given, for seated parties just the time when they start;
- sometimes, especially for standing receptions, we should send more invitations (by 20–30%) to have the expected number of guests. An empty room never makes a good impression.

### 1.7.2. Cocktail party

The cocktail party is one of the most popular types of reception, due to their associated practicalities. Usually, it is organised in the late afternoon, at the end of a business day (e.g. from 5 P.M. till 7 P.M. or from 6 P.M. till 8 P.M.). From the organisers’ point of view, it allows quite a substantial group of people to be hosted at the same time, implies relatively little cost, saves time, offers a more relaxed atmosphere and provides an opportunity to renew or establish new contacts with people from other fields (business, the media, administration, science, politics, art, etc.). Advantages to the guests are that they do not have to come precisely on time, may leave whenever they wish, are entirely free to choose their interlocutors, and do not have to be dressed very formally.

The cocktail party has also got its weaknesses, such as standing for quite some time, eating food while you are standing up and holding a drink (small, high tables may be of some help), being exposed to risk of stains on the clothes because the crowd is so dense, and rather moderate amounts of food that will not satisfy hunger.

When planning a cocktail party, you must take care of some issues. Firstly, the room<sup>3</sup> where it is taking place should be empty, no chairs or

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<sup>3</sup> A cocktail party may be organised in a garden.

other places for seating. Otherwise, some guests will be sitting, some standing, which does not provide a convivial atmosphere. Hosting an elderly or disabled person is an exception.

Secondly, guests should be able to avail themselves of **the bar**, either a self-service one or preferably with the assistance of professional bartenders. The bar must offer a variety of alcohols and soft drinks used to make cocktails, such as vodka, gin, tequila, whisky, cognac (brandy), champagne, white and red wine, beer, wine made of herbs, juice, soda, mineral water and other sweet and dry sparkling drinks. Ice must be provided in sufficient quantities together with slices of lemon or lime. Ensure the required range of glassware used for drinks you plan to serve. A substantial stock of napkins is vital as they will be used to hold glasses with ice-cold drinks.

Thirdly, **a cold fork buffet** is a must. Hot appetizers will be served by waiters. Independently of what is served, and food imagination being the only limit, these should be bite-sized portions that do not require the use of a knife. Hence, we may serve small sandwiches, canapés, mini pizzas, mini quiches, mini shish kebabs, roulade, and cheese. Olives are also frequently on the menu, as are dips with chopped raw vegetables (carrot, cauliflower, celery) and fruit (slices of pineapple, water melon, strawberries, seedless grapes). They are eaten with fruit forks or special picks. Avoid stone fruits as getting rid of stones is troublesome for guests. Although there is not much food at a cocktail party, the menu must be of top quality, unusual, diversified and nicely served. Planning an intriguing buffet is far from easy.

Fourthly, during the party waiters should regularly clean away plates, glasses, napkins, etc. used by the guests, otherwise their omnipresence may spoil the taste and aesthetic experiences.

It is polite when the host of the cocktail party, possibly with a colleague or companion, greets arriving guests in person and welcomes them in. That is why when the cocktail starts they should spend ca. 20 minutes at the door shaking hands with guests. Also, ca. 20 minutes before the end of the party, they should be at the door again to say goodbye to those who leave. Remember, **at a party the guests are having fun** and the hosts work. One of their duties is to ensure the smooth course of the meeting in a pleasant atmosphere and, e.g., introducing people to each other or starting a conversation. Guests coming late and leaving before the end of the meeting have the duty to find the host to greet/say goodbye.

### 1.7.3. Seated parties

All seated parties are organised in a similar way, the only difference being that a lunch menu is less sumptuous than that of dinner. Planning a seated party, you must solve two issues: **seating arrangements and the menu**. The former depends on the room where the party is to take place, the number of guests, shape of the table (round, rectangular, oval), number of tables, and the nature of the meeting (working, social). The latter needs to take account of the season, products typical of it, culinary preferences (some guests may be vegetarian), cultural restrictions (e.g. there are nations who do not eat pork or beef), the variety of food (potentially we may choose to serve: cold starter, soup, warm starter, main course, cheese, dessert and fruit), calorie counts for the meals to be served (light and heavy food), and the selection and sequence of alcohols.

**The proper seating arrangement depends on concrete circumstances** and due to the limited size of the chapter, numerous options available will not be discussed and we will focus on general principles. However, we must bear in mind that they do not always unambiguously inform who should be seated where, and for such cases common sense is the ultimate criterion<sup>4</sup>.

The first rule is that the principal guest should be placed in the most prominent seat. Traditionally, it is the one facing the door or windows. In practice, it is important not to offer them a place next to the kitchen. Seniority is the second rule. For working functions, it is decided just by the position – sex and age are irrelevant. In social settings, when accompanying persons may be involved, sex may determine where you are seated. The third rule is right hand precedence, as the seat on the right of the host, hostess or the principal guest is more prominent than that on the left. These people are points of reference for other guests. Alternate seating is the fourth rule. For working functions, it means alternate guest-host seating, and for private events, men and women alternate.

Below, please find two of the simplest examples. At a working event and at a rectangular table, the host may be seated **in the middle of the longer side**, with the head of a foreign delegation opposite. This

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<sup>4</sup> E.g. precedence of women in social settings depends on whether they are single, married or widowed and among married women on their husbands' hierarchy. In most cases taking care of all these nuances would greatly complicate organising dinner, offering little improvement of the overall atmosphere.

is the so called **French table**. The deputy-head of the delegation will sit on the host's right while the third member of delegation will be placed on the host's left. The head of the foreign delegation will, in turn, have the deputy of the host on the right and the third in the hierarchy representative of the hosts on the left. By applying the right hand rule, alternate seating and seniority, the Reader will surely be able to place other guests at the table.

At a social event with the involvement of married couples, the host may be seated **in the middle of the top of the table** with the hostess seated opposite. This is the so called **English table**. The principal male guest is placed on the hostess's right and the second in the hierarchy on her left. The principal guest's partner will be placed on the host's right, and the partner of the second most prominent guest on the left. The order will be the same when, as in the above example, the female head of the delegation is the principal guest. She is placed on the host's right and her partner on the right of the hostess.

A seated event is usually preceded by **an aperitif**<sup>5</sup>, which is a standing reception of approximately twenty minutes, when dry drinks and snacks like peanuts and almonds are served to stimulate the appetite. It is an opportunity to initiate conversations, wait for all the guests to arrive and ensure that they are all seated at the same time. Although everybody is expected to arrive on time, in real life it is not always feasible for all the guests to reach the place exactly at the time indicated on the invitation.

For reasons pertaining to protection, the table is covered with a protective pad and then with a tablecloth, usually white or cream and big enough to hang over the table sides by 30 cm, perfectly ironed and, of course, with no signs of previous use. The setting starts with placing salt and pepper shakers and flowers to decorate the table. Then place settings for guests are prepared around the table leaving a space of 60 cm for each person. The main table has no space for alcohol bottles, which are placed on a side table together with mineral water and fruit juices, served in decanters or glass jugs (never ever in tetra packs or pet plastic bottles).

The setting includes a big, so called **base plate**, covered with a small napkin on which plates with dishes will be placed. It is positioned in the centre of the cutlery setting, arranged in the order for

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<sup>5</sup> The word "aperitif" means also "a short alcoholic drink taken before a meal to whet the appetite" (*The New Lexicon*, 1988 p. 42).

which it will be used. If, for example, the menu includes soup, fish and meat, on the right side of the base table and positioned the closest to it will be the meat knife, which will be used last, then the fish knife and a spoon, while on the left side of the plate there is a meat fork with a fish fork on the outside. Knives are placed with blades facing the plate, forks with the tines facing upwards. The dessert fork and spoon (or knife) are placed parallel to the edge of the table above the plate; the fork is laid below the dessert spoon, handle facing left while the spoon has the handle facing right. Glassware is positioned above the plate in the order for which it will be used. For the particular case mentioned above, the white wine glass would come first on the right, as white wine goes well with fish, followed by the red wine glass to accompany the meat and, possibly, a champagne flute for dessert. Glassware also includes a water glass and a glass for juice. Above the base plate, opposite the glassware, there is a side plate with a side (or butter) knife. Cloth napkins are indispensable; they are placed folded on the base plate or to the left of it. A napkin is placed on the lap to protect clothes and used to discretely and regularly wipe your mouth. The setting may be supplemented with the menu and a place card with the guest's name.

It is hard to imagine any such event without **alcohol**. There are certain general rules that govern its selection. Firstly, white vodka is basically served only with the starter. Secondly, white wine is served before red, and dry before sweet. Thirdly, if possible, the choice "white or red" should be left to the guest, remembering, however, that white wine is served with white meat (poultry, veal), fish, and egg dishes while red with red meat (deer, beef, lamb) and dry champagne matches any dish. Fourthly, cognac and liqueurs are served at the end of the event, together with tea and coffee. Fifthly, getting the real taste of some alcohol beverages requires proper glassware and serving temperature.

**Table manners** are vital, as their absence is clearly visible. Let us remember that a dinner, besides satisfying hunger, is also a social event where we are expected to have conversations with other guests. Sitting at the table, keep your elbows close to your body with only wrists touching the table. When eating using one hand only, e.g., soup, do not put the other elbow on the table. Never tuck a napkin into your collar. Bread is eaten in bite-sized pieces, spread with butter and placed in the mouth. Never ever lick the knife. Hold your wine glass by the stem, not the bowl. To signal you have finished eating to the waiters, your fork and knife

should be left parallel at 3:15 position on the plate<sup>6</sup>; if you intend to continue the meal cross knife and fork centrally on the plate but do not rest their handles on the table. Alcohol should be consumed moderately. When in doubt how to eat a particular dish (e.g. oysters, crayfish, caviar), observe the host/hostess discretely and follow them.

## 1.8. Personal appearance and dress code

There is a Polish saying which can more or less be rendered as “fine feathers make fine birds”, which best demonstrates the importance of this element of etiquette in professional relationships. Personal appearance is decisive for making the first impression, it builds up our credibility and informs others about our attitude to hygiene and tidiness. It also shows respect to others. It is not just an issue of individual image, as the personal appearance of employees contributes to the image of the organisation that they represent. That is why an employer is fully authorised to set and enforce a certain dress code or even fire a person for sloppy appearance. That refers in particular to those who are in direct contact with customers.

Among various aspects of appearance, **clothes, makeup and hairdo** are those that we can control the most (Mruk ed. 2004 p. 304). They should complement physical aspects such as height, features, complexion, figure as well as age and weight. Complementing consists in highlighting positive features and hiding less positive ones. Personal hygiene in a broad sense, i.e. washed hair and body, no unpleasant body odour, brushed teeth and fresh clean, unbitten nails, clean and ironed clothes, clean shoes, etc., is always a point of departure.

Being *dressed* not *clothed* is an art, hence public personalities for whom image is vital for winning credibility and sympathy often use the advice of stylists. The multiplicity of details encourages the publishing of all sorts of guidelines and advice on the subject, especially in life-style magazines. Here, however, we will discuss only basic and general principles.

As we have already stated, clothes which are tidy and complement the wearer's features are the main requirement. A corpulent person, for example, should avoid big prints or horizontal stripes and a pale complexion does not go well with dark colours. The second principle

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<sup>6</sup> In other countries, e.g. in Great Britain, it may be the 6 o'clock position.

reminds us to consider what event we are going to attend. Black, rather than beige or any other bright colour, is appropriate for funerals, for meetings held after 6 P.M. we should not wear a bright or brown suit, or a black suit before 8 P.M. The third rule speaks of harmony. The point is to adequately choose elements of the outfit and match colours. For example, a bag used when going shopping is not appropriate at a party, and sports shoes should not be worn with a suit. It is risky to wear a suit, shirt and a tie which are all striped as is to trying to match more than two colours. Attention must be paid to change elements of our attire so that we are not identified with just one jacket or dress, and we should also consider the quality of the clothing, the accessories and their sizes.

In the workplace we can practically choose between three styles (Kędziora 2013). Firstly, formal one. For a man it means a grey or dark navy blue suit, a white shirt with a tie, and lace-up leather shoes, so called *oxfords*. For a woman, a dark navy blue or dark grey two-piece suit (skirt or trousers) and a blouse, a little black dress, and leather mid-heeled court shoes. The second style could be termed semi-formal (*smart casual, business casual*). In this case, a man may wear a jacket made of a different fabric than the trousers, a coloured plain, striped or checked shirt with or without a tie, a T-shirt, and leather shoes. A woman may choose between a suit, a long-sleeve shirt dress or a skirt and a blouse, and high-heel leather court shoes. The third category, casual, for a man provides for cotton (corduroy, jeans, chinos) trousers, a coloured sports shirt or a T-shirt, a turtleneck, jacket and sports shoes. Women wear similar clothes but they can opt for a skirt instead of trousers.

The above characteristics have been given as very general guidelines only. Nothing has been said about outerwear (coat, jacket). All styles come in varying degrees of sophistication, for example the semi-formal style includes a brown suit, a blazer and grey trousers, a tweed jacket and wool trousers, a wool jacket and cotton chinos-style trousers. Shirts, T-shirts, shoes and accessories (tie, handkerchief, cufflinks, belt) may make the outfit more or less sophisticated to tailor it to a particular occasion.

To conclude, we will list the most often made business clothing mistakes. For men these include:

- the tie: worn with a short-sleeved shirt, with a shirt unbuttoned at the neck, too long or too short (it should reach the top of the belt); made of the same fabric as the handkerchief (pocket square);



- socks: too short, exposing bare leg; made of thick fibre and worn with a suit; not matching the colour of the shoes; worn with sandals;
- ball pen, glasses placed in a suit pocket;
- jewellery: anything other than a watch, wedding ring and cufflinks;
- wearing an unbuttoned suit jacket; trousers with crease marks in the crotch and under the knees; a short-sleeve shirt worn with a suit.

For women:

- too strong makeup, too low neckline, above the knee skirts, transparent blouses;
- cut out shoes (toes, heels), high heels;
- going bare-legged or wearing patterned tights;
- too much jewellery, especially rings; mixing gold and silver jewellery.

### **Questions and assignments**

1. Plan a dinner menu for June for delegations from India and Israel.
2. Propose snacks for a cocktail party to be thrown in September.
3. A person is calling and demanding to be put through to the CEO of the company but he/she refuses to introduce her/himself. How should the secretary who answers the call react?
4. What would you say to your colleague at work who: (a) does not use deodorant? (b) uses vulgar expressions?
5. From the hosts' point of view, what are the advantages of French and English table seating arrangements?
6. How do labels inform consumers about the quality of wine? cognac? whisky?
7. A girl-friend shows you her new blouse. You think it looks awful on her. What would you say?

8. Should there be any *dress code* at university, and if yes, what, for:  
a) male lecturers?; b) female lecturers?; c) male students?; d) female students?

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# Chapter 2

## Business plan

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### 2.1. Notion

To an enterprise, a business plan is a planning tool which describes future activities and the ways of delivering them, taking account of external and internal circumstances. It may also be defined as a document, which:

- a) sets out a work programme (plan) of an enterprise,
- b) shows whether the plan is feasible and realistic,
- c) demonstrates that its implementation may bring benefits to the enterprise.

**It is clearly a future-oriented document.** A business plan uses various predictions connected with the business environment, such as forecasts, programmes or plans. First of all, it formulates assessments with respect to the future performance of the enterprise in question, which will be attained as a result of the implementation of the planned development projects. The present situation is the starting point for considerations relating to the future.

**The business plan is a realistic document.** Usually it is developed to deliver concrete actions within an enterprise, not to meet formal requirements. The only exception is certain subsidies, for which a business plan must already be submitted in the application procedure to demonstrate that the project is feasible. The business plan should realistically assess the feasibility of the planned goals and the practical ways of reaching them. That is why it must be based on an analysis of the current economic

situation and its authors have to provide evidence that the goals can be attained in a given economic, legal and social environment.

**The business plan demonstrates that the economic operator will benefit from implementing the tasks outlined in it**, i.e. that at a specified time in the future, the operator will arrive at a planned and desired situation. As a rule, it means achieving adequately high profit under given circumstances. Sometimes, enterprises instigate actions to attain other objectives, such as environmental protection, improving employees' skills or health and safety conditions at work.

**A business plan is always in writing.** Thus, considerations on how to establish or develop a business may not be considered a business plan. A professionally written business plan draws knowledge from economics, especially microeconomics, finance, marketing, management and organisation, and risk. Legal aspects make its vital complement. The authors must have knowledge and practical information on the environment in which the project will be delivered.

The owners of small firms often choose to write a business plan themselves. The advantage of such an approach is that they have the vision of the project in question and the full set of data on how the business operates. A lack of knowledge and experience in writing business plans may be an issue, however, implying the need to involve someone from outside (e.g. a consultant), who could give advice while preparing the document and assess its final version. Business plans for bigger economic entities should be developed by a team, usually composed of owners, managers, key employees as well as representatives of organisations in the business environment (consulting firms, development agencies, entrepreneurship incubators and accelerators, industry and technology parks, universities, etc.).

## 2.2. Characteristics

A professionally written business plan should have certain characteristics to ensure the best efficacy and efficiency of the planned investment project. Hence a business plan must be:

- a) concrete – i.e. based on facts and credible data,
- b) up to date,
- c) comprehensive and compact,

- d) honest and optimistic,
- e) attractive to read,
- f) flexible,
- g) verifiable,
- h) confidential.

A **concrete** business plan means it is based on facts and facts only, with goals being their natural outcome. Intuition or assumptions are not good foundations of a business plan. Facts in a business plan include a binding legal order, the economic situation at home and abroad, the market structure and mechanisms, costs of production, the labour market situation, and other factors. The goals in a business plan must be concrete, meaning they must be expressed in numbers and achieved within a clearly specified time limit. The document uses various figures which may come from statistical institutions (e.g. the Central Statistical Office of Poland – GUS, Eurostat), producers' associations and companies, business intelligence companies, the results of purchased surveys, own analyses, etc. The figures most often represent the prices of sold products and purchased materials, the size and structure of sales, and competitors' performance. The figures should be approached with a lot of criticism. You must find out the scope of the data concerning things such as sales (do they include illegal markets?). In international comparisons, you need to examine whether the calculation method is the same in all analysed countries (e.g., how the unemployment rate is estimated, as it may well be based on a different methodology in each EU Member State).

An **up to date** business plan means it is based on data that are not outdated, in particular on binding legal acts, data pertaining to the market and the latest forecasts and up to date figures.

At first glance, expecting a business plan to be **comprehensive and compact** at the same time might seem contradictory. Comprehensive-ness (completeness) means the plan provides an exhaustive description of the project and makes references to all the key areas of business operations essential for the delivery. There is nothing like a partial business plan, one that could omit some of these areas. Such a document would be untrustworthy. A business plan that, e.g., disregards the market

situation is completely useless. Compactness does not mean you should not make a business plan as detailed as possible; primarily it should be written to such an extent that it demonstrates that a project is feasible and its implementation will bring the expected benefits. An in-depth exploration of other detailed aspects should be avoided. You may draft appendices with additional information, such as a detailed cost estimate for construction and assembly works, or the list of products sold in the shop. The length of a business plan depends on the complexity of the project and the size of an enterprise, and it usually varies from several to several dozen pages.

A business plan should also be both **honest and optimistic**. That may raise some concerns as it sounds rather puerile. What can you do with an honest document that reveals a pessimistic picture and demonstrates that a project stands no chance of being successful? The answer is simple: such a document is not a business plan, which is optimistic by nature (its role is to show that plans are feasible and their accomplishment will bring benefits). When you write it for yourself it must obviously be honest. Doubts may arise over business plans used when applying for external funding. People are sometimes tempted to present such a project as more attractive than it really is. However, we need to note that a loan, subsidy or borrowing is not a goal in itself, or at least it should not be one. They are tools helpful in the successful implementation of a project. If the plan is poor, the firm in question will not be successful and it will face problems in paying the subsidy back. Nowadays, product and outcome indicators are, as a rule, set too ambitiously in projects, and enterprises are unable to meet them.

Business plans should not avoid showing the potential threats and difficulties that may appear in the course of its delivery. They never automatically discredit a project since any economic activity involves an element of risk. Taking account of threats and difficulties is even required by those who assess business plans, however, the two should be accompanied by showing the ways of dealing with them. If no coping strategies are presented, and difficulties are linked to fundamental aspects (e.g., planned sales or lack of stability in supplies of basic materials), it is not worth getting a loan, since the project will produce losses.

When a business plan is written for its author (e.g., for a start-up) its **attractiveness** to the reader is marginal. However, if you want the management, investor, creditor, or borrower to read it, or when you are looking for partners, the document should be easy to read, stylistically

correct, and well edited. Obviously, one must always remember that attractiveness for the reader is an important quality of a business plan, but the most important are its substantive merits. Stylistic correctness is about clarity and unambiguous statements, especially pertinent to application procedures. The language of a business plan should be reserved and the description of a project should not be overly optimistic. When editing the text to facilitate the reading of a business plan, care should be taken to ensure its clear layout. To this end you may use technical solutions available in the software: various font sizes, using bold and underlined words, frames, etc. Text may also be written in different colours, although that is not necessary. An executive summary, usually placed at the beginning of a business plan, is an important part as it makes the reading easier.

A business plan should be **flexible**. It means its implementation should be possible even if not all assumptions with respect to the future are met, e.g., when achieved prices are below the expected level. Plans' resilience to changes in assumptions and implied risk remains an open issue.

A business plan does not have to be written just for one particular occasion. It is a document that should be **verified** if, in the course of implementation, new factors emerge that influence its delivery.

Business plans often include confidential information concerning, inter alia, the idea of the project, protection of intellectual property rights, promotion, sources of supply or unit cost. This is the reason why the document should be **confidential** and made available to a closed group of people.

## 2.3. Using a business plan

A business plan may be written for internal or external purposes. It is a document which supports business management and is a vital planning tool facilitating the implementation of a project. It delineates actions to be taken to achieve the goal. A business plan may be prepared at different stages of an enterprise's history:

- a) before it has been established, to verify the rationale behind starting a business and to attract financing for a start-up (granted once) (Example 1);

**Example 1.** Application form for start-up grant<sup>1</sup> – template

- I. Applicant data (e.g., her/his status on the labour market, participation in social integration centre workshops, social integration clubs);
- II. Information concerning planned business activities, including:
  - a) general description of planned business project,
  - b) type of planned activities (Polish PKD),
  - c) business location where the activities will be performed,
  - d) any previous business history including the reasons why it was ceased,
  - e) required licenses, authorisations, permits,
  - f) completed courses, including those in the area of starting and running a business,
  - g) documented skills and professional experience directly linked to the planned business activity,
  - h) possible contracts, references, preliminary cooperation declarations signed with suppliers, customers and subcontractors,
  - i) ways of securing the repayment of funds received to start up a business, e.g. a warranty, endorsed bill of exchange (an aval), bank guarantee, collateral, assets frozen in a bank account, notary act by means of which the debtor subjects himself to the creditor's recovery proceedings,
  - j) marketing analysis and market characteristics,
  - k) profitability and efficiency analysis of the project, including sales, costs, and profit forecasts.
- III. Financial analysis, including:
  - a) costs relating to starting a business and sources of its financing (own resources, external resources), including:
    - purchase of fixed assets, machinery and equipment,
    - purchase of operating assets,
    - purchase of means of transport,
    - purchase of advertising services and materials,
    - renting space for the business,
    - costs of legal assistance, advice and consultancy,
  - b) detailed specification of expenses to be borne from the grant, how they will be evidenced (VAT invoice, sales contract) and justification of outlays.
- IV. Appendices including declarations concerning:
  - a) refraining from taking up employment within 12 months of the starting of the business,
  - b) obligation to pursue business activities for the period of 12 months from its start date and not to apply for its suspension within the same period,
  - c) being free from any financial obligations vis-à-vis target funds,
  - d) de minimis aid.

Based on the documents of the County Labour Office in Lodz, [www.pup-lodz.pl](http://www.pup-lodz.pl).

<sup>1</sup> For grants financed by County Labour Offices under the Act on Employment Promotion and Labour Market Institutions (Journal of Laws – Dz.U. of 2015, item 149, 357, 1066), the amount may not exceed the average statutory salary multiplied by six.



- b) when the business is up and running, to take decisions on the change of production profile, modernisation, development or remedy projects, etc. (Example 2);

**Example 2.** Business plan template for investment projects under the Regional Operating Programme for Lodz Voivodeship 2007–2013

1. General Applicant-related data and information
  - 1.1. Applicant data
  - 1.2. Applicant's business activity
  - 1.3. Business profile
2. Marketing plan
  - 2.1. General product/service characteristics
  - 2.2. Market
  - 2.3. Competition
  - 2.4. Distribution and promotion
  - 2.5. Price
  - 2.6. Sales forecast
  - 2.7. Revenue
3. Project implementation
  - 3.1. Project description
  - 3.2. Project location
  - 3.3. Description of planned investment
  - 3.4. Project innovation
  - 3.5. Material scope of the project, cost estimates and implementation timetable
  - 3.6. Detailed cost estimation for eligible activities
  - 3.7. Justification of costs to be incurred
  - 3.8. Sources of funding eligible expenses within the project
  - 3.9. Resources enabling project implementation
  - 3.10. Institutional capacity to deliver the project
4. Applicant economic and financial analysis
  - 4.1. Simplified Balance Sheet (**Appendix 1**)
  - 4.2. Profit and Loss Account (**Appendix 2**)
  - 4.3. Cash Flow forecast (**Appendix 3**)
  - 4.4. Financial indicators
  - 4.5. Net Present Value (NPV<sup>2</sup>) and Internal Rate of Return (IRR<sup>3</sup>)

Based on the documents of the Marshal Office in Lodz, [www.rpo.lodzkie.pl](http://www.rpo.lodzkie.pl)

$$^2 \text{ NPV} = \sum_{t=1}^n \frac{\text{CF}_t}{(1+r)^t}, \text{ where:}$$

$r$  – discount rate,

$\text{CF}_t$  – net cash flow in  $t$  period,

$t$  – subsequent periods (years) of the investment and project,

$I_0$  – initial investment outlays,

$n$  – period (number of years) within which an investment project is carried out.

- <sup>3</sup> IRR – internal rate of return (discount) for which  $\text{NPV} = 0$ ; (equation result  $\text{NPV} = 0$  with reference to unknown  $t$ ).

- c) for ownership transformations in an enterprise;
- d) in relation to liquidation, to prepare the organisational side of the process.

A business plan may be useful for external entities (mainly financial institutions and potential investors) when:

- 1) an enterprise applies for loans, borrowings, grants, EU and similar funds to finance a project;
- 2) an enterprise is looking for partners to collaborate with;
- 3) assisting internationalisation of business by, e.g., co-financing the participation in fairs and missions abroad where usually an application and a business plan make one integrated document (**Example 3**).

**Example 3.** Application form for subsidies co-financing participation in fairs and missions abroad – template

- A. General data** (scheme, priority, measure, type of financing);
- B. Applicant's (beneficiary's) data**, including: enterprise contact data, project partners, type of business activity, products/services offered, revenue from business, factors influencing demand for products/services offered, beneficiary's market position, R&D department in the enterprise, human and technical resources ensuring proper delivery of the project;
- C. Project description**, including: event place and time, project justification, detailed description of the course of the project, goal, sustainability, promotion, complementary links with other projects of the beneficiary, experience, preparedness to implement the project;
- D. Project performance indicators**, including: measureable product and outcome indicators, ways of monitoring the project and frequency of calculating the indicators;
- E. Subsidy**, including: amount and type of State aid and information on potential revenue generated by the project;
- F. Project impact upon horizontal policies**, such as: equal opportunities, competition and public procurement, environmental and sustainable development, IT society, and employment policies;
- G. Project financing**, including: amount of subsidy, VAT tax eligibility, expenses covered by flexibility mechanism (cross-financing), sources of funding, how the funding is secured, the use of advance payments system;
- H. Scheduling materials and finances**;
- I. Applicant economic and financial analysis**, including: balance sheet, profit and loss account, cash flows, financial indicators (current and fast liquidity, stock rotation, receivables and liabilities, indebtedness, profitability of sales and return on equity (ROE));

Based on the documents of Entrepreneurs' Service Centre in Lodz, [www.cop.lodzkie.pl](http://www.cop.lodzkie.pl)

Having a business plan is good irrespective of the size of an enterprise. We need to stress that:

- 1) writing a business plan is not a “miracle solution” that would automatically make a project successful but it reduces the risk of failure,
- 2) writing a business plan makes the entrepreneur re-think her/his plan once again, which will help them to better understand and implement it (or give up the project),
- 3) through the comprehensive approach typical of preparing a business plan, you may catch mistakes and gaps in project idea. If they can be rectified, the implementation of the project will be improved; if not, by giving the project up you can avoid additional losses,
- 4) a well-prepared business plan may become a “pass” to various types of financial assistance, even if initially the project was to be financed exclusively from the entrepreneur’s own resources.

On top of that, for small (micro) economic operators, a good business plan represents other advantages:

- 1) it offers them psychological support and reinforces the motivation to deliver a project,
- 2) It teaches to think in longer-term periods since owners of such businesses often focus on short-term goals only.

## 2.4. Contents

As we have already stated, a business plan must be flexible. It also means its contents must be adjusted to the nature of both the project and the enterprise. A single universal layout of a business plan does not exist. The literature offers business plans that differ in structure while financial institutions have their own requirements vis-à-vis the layout and form. That, however, does not imply substantive diversity. In accordance with the definition, each business plan must be complete and discuss all factors relevant for the feasibility of the project and benefits related to it. That is why constituent elements are the same: a description of the business, project and products, market and promotional activities, evaluation of human resources, financial forecast of sales, initial outlays, costs,

and profitability. With respect to the above, we may say the document is standardised. The level of detail and sequence of elements are different in different business plans depending on the situation, goals, and requirements of institutions who grant funding or other types of support.

A complete business plan should include the following components:

- 1) executive summary,
- 2) business description,
- 3) short description of the project,
- 4) products and services which will be manufactured (rendered) as a result of project implementation,
- 5) business location,
- 6) initial outlays,
- 7) financing initial outlays,
- 8) market analysis,
- 9) promotion activities,
- 10) human resources,
- 11) supplies of raw materials for production (services),
- 12) other operating costs of production,
- 13) project timetable,
- 14) financial forecast,
- 15) risk factors.

#### **2.4.1. Executive summary**

An executive summary (abstract) is usually placed at the beginning of the business plan, but it is written after all elements have been finalized. It facilitates the reading of the document and understanding the goal of the project. An executive summary is especially important when you want to attract the interest of bankers, potential investors, and evaluators. Its task is to encourage them to read the entire document. Hence,

a summary should be especially attractive and relatively short. It should not exceed two pages (Skrzypek, Filar 2007, p. 59). To ensure text clarity and transparency, it is advisable to write it in paragraphs. The summary should give a concise picture of the project, demonstrate its feasibility and identify potential effects.

**Table 2.1.** Substantive scope of an executive summary

No.	Required data
1.	Brief description of the project for which the business plan has been written, including its goal, products (services) that will be placed in the market, initial outlays
2.	Target market
3.	Management of the enterprise including the team who will deliver the business plan
4.	Factors of comparative advantage compared to other entities offering the product (service)
5.	Financial forecasts

**Source:** Authors' studies.

## 2.4.2. Business description

This part of the business plan presents basic data about the enterprise. Usually, the business description is divided into components relating to the historical and present situation (Pasieczny 2007, pp. 27–28). The part also includes data that identify the enterprise (Skrzypek, Filar 2007, pp. 59–60).

**Table 2.2.** Basic data and information about the enterprise

No.	Required data
1.	Enterprise data including: name, contact data, organisational and legal status, owners
2.	History – date of establishment, products or services, major achievements, financial standing within not longer than the last 3–5 years
3.	Present situation – description of assets, products and/or services, market position, current financial standing
4.	Major strengths and weaknesses of the enterprise

**Source:** Authors' studies.

### 2.4.3. Short description of the project

An introductory part, which includes basic information about the project:

- 1) identification of project idea,
- 2) reasons why the project will be delivered,
- 3) possible actions undertaken before the beginning of the project.

### 2.4.4. Products and services covered by the project

This section describes products (services) that will be manufactured (rendered) as a result of the implementation of the project. The way they are described depends on what kind of products or services you are dealing with. When a product is common (e.g., clothes), you must focus on characteristics that distinguish it from other products available on the market. If it is a specialist product (e.g., a complex system to be installed in a machine or equipment), explaining what it is used for needs to be stressed (Pasieczny 2007, p. 55).

Differences in description will also come up when we are dealing with a standard or tailor-made (individualised) product. In the first case, its characteristics are the same as those of products offered by competitors (within a given standard, e.g. mineral raw materials). Tailor-made products (e.g. passenger cars) represent qualities that differentiate them from products offered by competitors and they need to be highlighted in a business plan. This is particularly relevant for services which are extremely tailor-made. Identification of the stage in a product's lifecycle is vital for forecasting demand dynamics and developing a promotional plan in accordance with marketing mix rules.

**Table 2.3.** Products and services

No.	Required data
1	2
1.	Product (service) in accordance with statistical classification of GUS
2.	Product (service) – description, structure, parameters, technology, use

**Table 2.3.** (cond.)

1	2
3.	Is a product (service) standard or tailor-made, how does it impact technical progress; what will the varieties of the product (service) be; to what extent is the assortment differentiated
4.	Characteristics that distinguish a product (service) from those already available on the market
5.	Product (service) lifecycle stage

**Source:** Authors' studies.

#### 2.4.5. Business location

Business location is crucial as it may seriously influence sales opportunities, effective promotion or costs. When choosing a new business location or a location for a branch of an already existing enterprise, account should be taken of the following factors: rent (leasing), availability of the place, competition, access to markets, business-specific factors (e.g., burden to local residents, environment) (Pasieczny 2007, pp. 40–41). When it comes to services, location is vital when they are rendered in the firm's premises (e.g., hospitals, schools, retail trade).

#### 2.4.6. Initial outlays

This section of a business plan is an extended project description. You are expected to present briefly the production technology (how services will be rendered), identify other available technologies and justify the choice. Discussing stages of the production process (service) is recommended. In addition, here you can find information on additional production (service) capacity that will be achieved as a result of the project.

Individual items of initial expenses need to be described by assigning concrete values, features and purchase justification. In particular, you must provide precise data for more valuable machinery, equipment and devices. Usually we give the name and type of the equipment, manufacturer (brand), place and value of the planned purchase. If you are buying second hand equipment, the date of production is required. If the purchase is subject to the procedure laid down by the Public Procurement

Law or similar, you may not specify the manufacturer, supplier, contracting party, etc. upfront. The selection will be decided in a bidding procedure which will decide who will be awarded the contract for supplies, services, or construction works.

To deliver the project, you need not only fixed but also operating assets. Hence, initial outlays also include the cash necessary to maintain liquidity at the beginning stages. Cash may be needed, e.g., to pay for materials used in production before any sales revenue has been earned. It is convenient to list investment expenditure using the scheme from Table 2.4.

**Table 2.4.** Initial outlays – structure

No.	Item	Value in PLN (or other currency)
1.	Real estate purchase	
2.	Construction, assembly and adaptation works	
3.	Machines, equipment, devices	
4.	Intangible assets	
5.	Other investment expenditure	
6.	<b>Total investment outlays</b>	
7.	Operating resources at the start	
8.	<b>Total initial outlays</b>	

**Source:** Authors' studies.

#### 2.4.7. Financing initial outlays

Initial outlays may be financed from different sources, which may include: own resources, borrowings, loans, subsidies or EU funds. A business plan should explain the structure of these sources. It may be done in a table. For loans and borrowings, you need to specify the expected terms on which they will be granted. You also must provide the timetable for repaying instalments and interests.



**Table 2.5.** Initial outlays – sources of funding. Timetable for repaying loans and borrowings (in PLN)\*

Item	Before Q1 2016	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2017	2018
Sources of funding							
Own resources							
Subsidies							
EU funds							
Loans and borrowings							
Other sources of funding initial outlays							
Repayments of loans and borrowings							
Paying interests on loans and borrowings							

\* For forecasts in this chapter we assumed that the business will start at the beginning of 2016 and the timeline for the forecast is 3 years.

**Source:** Authors' studies.

### 2.4.8. Market analysis

Having a good product or being able to offer a top quality service gives no guarantee of successful sales. There must be people willing to buy them, meaning they must be attractive in terms of characteristics and price. Market analysis gives information about sales opportunities for particular products/services.

Thus you need to estimate, even roughly, the size of the market, identify the population of buyers and sales. Then, you continue with market segmentation. When the offer is addressed to consumers, segments (niches) are usually identified based on domicile – the geographical criterion (town or countryside), the distance from the firm and demographic criteria: sex and age. These may be complemented with other criteria, such as education, profession, income, interests or lifestyle. Enterprises which export their products base segmentation on countries and regions of the world. Having selected the segment which will be

your target market (while identifying the plan of market activities in paragraph 2.4.9) you must provide in-depth characteristics. Brief characteristics of individual segments are also attached.

Next, you must identify your competitors. List them first and divide them into principal, secondary and potential, who might pose threat in the future (Kowalczyk 2001, p. 100). Activities of principal competitors require a thorough analysis to estimate their sales, the products (services) that they offer, the quality, prices and terms of sales. The analysis should also cover distribution channels, promotion, financial resources, stock and business reputation. You need to highlight the strengths and weaknesses of at least some principal competitors.

When analysing market development perspectives, attention is paid mostly to future trends in demand size and structure, the potential evolution of customer preferences (e.g. influenced by technological progress), the stability of legal regulations and competitors' behaviour.

What methods should be applied in market analysis? Information about the market and its prospective development can be obtained primarily from secondary sources: websites, papers, and reports. Market data are also available from specialist business intelligence companies. This is how international market data are often received. When it comes to primary research, large firms receive precise market data from their own extensive direct studies and in-depth interviews. It is recommended that small economic entities watch their competitors – their outlets and offer.

**Table 2.6.** Market analysis in a business plan

No.	Scope of market analysis	Necessary data
1.	Size of the market	estimated population of market participants and sales
2.	Market segment	capacity, general characteristics, customers' needs and expectations
3.	Target segment	clients' characteristics, sales, potential capacity of the segment, customers' needs and expectations, factors decisive for purchase decisions
4.	Competitors' characteristics	List of competitors, estimated sales, operational strategies, strengths and weaknesses
5.	Market development forecast	demand directions and trends

**Source:** Authors' studies.

#### 2.4.9. Market activities plan

Market analysis allows for the selection of the segment (or niche) that will become the enterprise's target market for the project.

Then, the enterprise needs to identify the marketing objectives and plan activities that will help to achieve them and use marketing instruments in the areas of product, price, distribution, and promotion (the marketing mix). Marketing objectives belong to the fields of sales and meeting customer needs over shorter or longer periods. Short-term objectives may be related to, e.g., participating in trade events and establishing business contacts; long-term ones include, e.g., arriving at a target market share, extension of the distribution network, or creating an appropriate image of the business and its products (services).

Achieving the planned level of sales is the primary marketing objective. It is identified based on the forecasting revenue from sales, one of the key components of a business plan. How future sales are estimated is decisive for variable costs and also, to some extent, overheads. Sales are decisive for future profit. Drafting a sales forecast is not an easy task and it is highly uncertain. Some estimation methods are available but none can eliminate the uncertainty. Forecasting sales for a new business may be based on previous trends in sales, experience, competitors' sales or orders (if a business has already received any). You may also calculate the so-called free market share by deducting competitors' sales from potential demand (Pasieczny 2007, pp. 98–107).

A sales forecast is conditional, its trustworthiness depending on the accuracy of adopted assumptions concerning sales prices, sales structure broken down by products (services), seasonality, market development directions, adopted competition strategy and other factors. A sales forecast can be conveniently presented in a table as shown in the example below.

Among the product-related activities that assist in achieving marketing objectives, the following are worth our attention:

- 1) ensuring that the quality profile of products (services) is satisfactory for clients from the target market,
- 2) equipping products with characteristics that will distinguish them from competitors' products (design, sizes, packaging, labels),
- 3) adoption and implementation of brand strategy,
- 4) ensuring appropriate service and warranty terms.

Table 2.7. Sales revenue forecast for products and services (in PLN)

Item	Price	2016						2017		2018	
		1st quarter		2nd quarter		3rd quarter		4th quarter		amo- unt	value
		amo- unt	value	amo- unt	value	amo- unt	value	amo- unt	value		
Product (service) A											
Product (service) B											
Product (service) C											
.											
.											
.											
Product (service) Y											
Total											

Source: Authors’ studies.

While using marketing tools with respect to price, first you need to learn the prices offered by competitors. The key issue to be addressed here is the comparison of prices of the enterprise in question with those of its competitors. Setting prices too low may yield very little profit and make a business go bankrupt while too high prices may discourage clients. When pricing your products, take various factors into consideration: costs, product quality, buyers' taste and habits, effect of competition, market situation, seasonality, price elasticity of demand and the enterprise's goals.

To be able to sell its products, a business must find customers and reach them via appropriate distribution channels. In the service industry, direct channels are of specific relevance as they imply direct personal contact between a service provider and the client. In production, the distribution channels may vary. Direct ones include door-to-door canvassing and mail order sales. Indirect distribution channels are, *inter alia*, retail and wholesale trade. Some of the factors to consider when selecting a distribution channel are the type of products (services), customer expectations with respect to how products are sold, shaping the image of a company and costs.

Other project success factors include proper planning and the execution of promotion activities. Their goal is to inform potential buyers about the firm's offer. Promotion must be well thought over and tailored to the specificity of the target market. It should be discussed in concrete terms in the business plan (e.g., an ad in "Gazeta Łódzka" newspaper, the size of 30 cm<sup>2</sup> published every Friday in the first year of business). The scope of promotion is usually dictated by costs. Hence, you need to carefully forecast the cost of promotion.

**Table 2.8.** Market activities programme

No.	Activities
1.	Select target markets (from among the segments described in the previous paragraph)
2.	Adopt assumptions for sales forecast (preferably in paragraphs)
3.	Sales forecast (sales objectives)
4.	Other marketing objectives
5.	Product-related policy
6.	Pricing policy
7.	Distribution channels
8.	Promotion activities

Source: Authors' studies.

### 2.4.10. Human resources

The quality of human capital (resources) plays a key role in the success of a project, in particular, in services based on direct contact between an economic operator and its customers. This section of the business plan should introduce the management team and stress their capabilities (competence) to run the business and manage the enterprise. Their characteristics should provide data concerning education, previous business career and professional achievements.

People who will be employed as a result of the project are characterised more generally by giving their number and desired skills. You also assess the possibility of recruiting such people. The remuneration policy needs to be identified together with a forecast of the cost of employment. This section outlines the organisational chart of an enterprise after the completion of the project.

**Table 2.9.** Human resources in business plan

No.	Required data
1.	Management team presentation (top)
2.	Demand for people with adequate skills (employees)
3.	Forecast of the gross cost of employment
4.	Organisational chart

**Source:** Authors' studies.

### 2.4.11. Supplies of materials for production (services)

Materials for production may include raw materials, materials or components. To start with, you need to divide them into basic and auxiliary and focus on the first group in the analysis. When materials for production are generally available and offered by many operators, you do not need to analyse suppliers. Otherwise, suppliers must be described and you must demonstrate that they will be willing to maintain business relations with the firm (preliminary contracts are an asset). The calculation of the costs of materials, raw materials and components are performed based on unit consumption and sales revenue forecast.

**Table 2.10.** Supplies of materials for production (services)

No.	Required data
1.	Types of materials for production
2.	Availability of basic and auxiliary materials for production
3.	Suppliers
4.	Forecast of material costs

Source: Authors' studies.

#### 2.4.12. Other operating costs of production and their forecast

The above discussed business plan sections include cost forecasts of granted loans and borrowings, promotion, materials for production, salaries and costs related with them. This section presents the calculations of the remaining operating costs. Care should be taken not to overlook any cost element in the forecast. You should also allow for unexpected costs, which are calculated as a percentage of overall costs. Table 2.11 is an example of cost components in an enterprise.

**Table 2.11.** Major production cost components – forecast (in PLN)

Item	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2017	2018
1	2	3	4	5	6	7
Raw materials, materials, components						
Energy, water, gas						
Gross employment costs						
External services						
Administrative costs						
Cost of promotion						

Table 2.11. (cont.)

1	2	3	4	5	6	7
Other costs of sales						
Major repairs, repairs						
Insurance						
Rent and lease costs						
Transport						
Fixed costs taxes (land tax, property tax)						
Depreciation						
Interests						
Other (please specify)						
Total						
Provision for unexpected costs (e.g., 10% of "Total")						
Total (final)						

Source: Authors' studies.

### 2.4.13. Project timetable

The timetable is a structured schedule of activities necessary to deliver a project. It helps to establish the sequence of individual operations, identify how long they will take, and strengthen discipline in the implementation stage. The timetable lists planned dates of the beginning and completion of the project and delivery dates of its major tasks. The timetable must be continuous and the time assigned for individual tasks should be realistic and adequate for their complexity. Some time must be provided to acquire the necessary permits and administrative decisions, to make settlements connected with subsidies and other projects financed from public resources, and public procurement procedures. Usually these stages cause delays in the implementation of investment projects.



#### 2.4.14 Financial forecast

The financial forecast is the core of a business plan. It informs the reader whether a project is profitable and will bring adequate benefits. The financial forecast uses data included in various sections of a business plan. Special attention is paid to data concerning initial outlays, production cost forecast and planned revenue from sales.

A business plan needs to make assumptions about prices used in forecasts and take account of inflation. Two methods can be applied in this case. Firstly, you may assume a specific rate of inflation for the period covered by the forecast (e.g., based on official government or national bank forecasts for a particular country). Having little credible inflation estimates for periods covering several years are a major disadvantage of this method. The second method consists in ignoring inflation and using current prices from the period when the forecast is made. This simpler solution may, however, distort future estimates of income and based profitability of initial outlays, and for these reasons it is applied, first and foremost, in periods of low and stable inflation.

The business plan must specify the time horizon of the forecast. Institutions which offer grants usually require that the entire repayment period be covered. In other cases, several years, often three, is a typical time limit. You also need to identify sub-periods for which you will prepare the forecast. Sub-periods depend on the sector, the type of project, the need to account for seasonal fluctuations, and other factors. Usually, the first year of the forecast is divided into quarters or months. For subsequent years, projections are most often made for annual periods.

The financial section of an extensive business plan includes the forecasts of the Profit and Loss Account, Balance Sheet, Cash Flow, and financial indicators. All of them use data from previous sections of the business plan. Profitability thresholds, and the overall profitability of the investment project in question, are also analysed. Financial forecasts should be presented with a comment.

Special importance is attached to the Profit and Loss Account as it gives a synthetic picture of how profit is created in a business. By comparing revenue from sales with costs, it shows the end financial results of the planned project in individual periods. In other words, it demonstrates the profitability of the project. The Profit and Loss Account may take different forms. When projects are developed for small enterprises, the financial forecast does not enter into more detail.

**Table 2.12.** Profit and Loss Account forecast<sup>4</sup>

	Item	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2017	2018
A	Revenue from sales						
B	Cost of production						
C	Gross profit (A–B)						
D	Insurance: retirement, pension, sickness, accident						
E	Sickness insurance (9% of base amount)						
F	Tax base (C – D)						
G	Income tax F*18% – tax-free amount – health insurance premium (7.75% of base amount) <sup>5</sup>						
H	Net profit (C–D–E–F)						

Source: Authors' studies.

#### 2.4.15. Risk factor

Risk can be defined as a probable (potential) and undesirable event that may prevent a business from accomplishing its goals (Ciechan-Kujawa 2007, p. 176). It implies the probability of occurrences that will adversely affect business performance and its development perspectives. Risk is a part of any business activity.

The business plan should list risk factors and ways of coping with them. Risks can be divided into systematic and business-specific. Systematic (external) risk cannot be controlled by the economic entity. It may be connected with forces of nature, the economic situation, technological progress or competition. Business-specific (internal) risk emerges in the area at least partly controlled by the business. Examples of such risks include business management, access to materials for production, the likelihood of losing liquidity or ineffective promotion. Specific risk may be particularly intense in the first periods of business activity.

<sup>4</sup> For an individual who runs a business and fully owns the revenue.

<sup>5</sup> Calculations for the lowest income tax rate.

Risk factors are often presented when conducting SWOT analysis. In accordance with its principles, based on data from the business plan, you identify key factors essential for the success of a project and divide them into internal, including strengths and weaknesses, and external, i.e., opportunities and threats.

The analysis should not be limited to the listing of risk factors. You need to explain how you will cope with them based on information included in the business plan.

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The business plan is one of the most important tools used in planning and developing business activity. As you have learnt from this Chapter, entrepreneurs may benefit from having a business plan. It provides a structure for business activities, helps to focus on specific goals and ensures a comprehensive approach to a project. On top of that, it facilitates the selection of realistic product and outcome indicators, moderates risk and helps to manage the investment project.

A business plan is also indispensable when you apply for external funding. It may also be used as a base document in granting start-up grants or subsidising investment projects in already existing businesses. Business plans are used by financial market institutions, regional development agencies and institutions entrusted with the management of EU financed programmes.

Obviously, a business plan is not an ideal tool. It may have disadvantages or inflict negative consequences upon an entrepreneur. Firstly, to prepare it you need the time and resources to cover additional costs. In the case of big investment projects, the preparing of a business plan may take some months and cost from over a few thousand to several tens of thousands of zloty. Secondly, the procedure may unnecessarily expand the team of people who get access to often innovative business ideas (e.g., consultants, business advisors, experts, assessors, representatives of institutions that operate subsidy schemes). Thirdly, business plan assessment procedures applied by various subsidy schemes raise objections. Sometimes entrepreneurs adopt very demanding, unrealistic indicators to improve the assessment of their projects. On the other hand, criteria are unclear and ambiguous, often leading to subjective assessments. Fourthly, quite often business plans are treated instrumentally and are disregarded in everyday business operations.

Summing up, knowing how to prepare a business plan may be useful when you run a business. Current business development opportunities through internationalisation, among others, have increased the importance of the instrument. That is why it is important for graduates of economic courses to have knowledge and practical skills in this area.

### Questions and assignments

1. What is a business plan?
2. What knowledge is necessary to write a business plan?
3. What does it mean that a business plan should be comprehensive and concise at the same time?
4. When is a business plan drafted?
5. What does it mean that a business plan is a standard document?
6. What are the main components of a business plan?
7. How are purchases of machinery, equipment and devices described in a business plan?
8. What methods are applied in market analyses conducted to write a business plan for a small business?
9. How is a sales forecast compiled?
10. What data concerning the owner is given in a business plan?
11. Why are costs increased with a cost reserve?
12. List the components of a Profit and Loss Account.

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## Appendices

- Appendix 1. Simplified Balance Sheet
- Appendix 2. Profit and Loss Account
- Appendix 3. Cash Flow Forecast

Appendix 1. Simplified Balance Sheet (in thousands of PLN)										
Assets	Year (n - 2) ....	Year (n - 1) ....	Current period ....	Year (n ...)	Year (n + 1) ....	Year (n + 2) ....	Year (n + 3) ....	Year (n + 4) ....	Year (n + 5) ....	Year (n + ...) ....
<b>A. FIXED ASSETS (I + II + III):</b>										
I. Intangible assets										
II. Fixed assets by type										
1. Land (including long-term land lease)										
2. Buildings, premises, and establishments										
3. Technical machinery and equipment										
4. Means of transport										
5. Other fixed assets										
III. Receivables, long-term investments, long-term accruals										
<b>B. CURRENT ASSETS (I + II + III + IV):</b>										
I. Inventory										
II. Short-term receivables										
III. Short-term investments (including cash)										
IV. Other current assets										
<b>TOTAL ASSETS (A + B)</b>										
<b>Liabilities</b>	Year (n - 2) ....	Year (n - 1) ....	Current period ....	Year (n ...)	Year (n + 1) ....	Year (n + 2) ....	Year (n + 3) ....	Year (n + 4) ....	Year (n + 5) ....	Year (n + ...) ....
<b>C. EQUITY (Capital)</b>										
<b>D. LIABILITIES AND PROVISIONS FOR LIABILITIES</b>										
I. Provisions for liabilities										
II. Long-term liabilities (1 + 2)										
1. Loans and borrowings										
2. Other										
III. Short-term liabilities (3 + 4 + 5)										
3. For supplies and services										
4. Loans and borrowings										
5. Other short-term liabilities										
IV. Accruals										
<b>TOTAL LIABILITIES (C + D)</b>										

Based on the documents of the Marshal's Office in Lodz, [www.rpo.lodzkie.pl](http://www.rpo.lodzkie.pl)

Appendix 2. Profit and Loss Account (in thousands of PLN)										
Item	Year (n - 2) ....	Year (n - 1) ....	Current period ....	Year n ....	Year (n + 1) ....	Year (n + 2) ....	Year (n + 3) ....	Year (n + 4) ....	Year (n + 5) ....	Year (n + ...) ....
<b>A. Net sales</b>										
I. Net sales of products and services										
II. Net sales of materials and goods										
<b>B. Operating costs:</b>										
Depreciation										
Materials and energy										
External services										
Taxes and charges										
Wages, salaries and staff related costs										
Other costs by type										
Goods and materials sold										
<b>C. Profit (loss) on sales (A - B)</b>										
<b>D. Other operating revenue</b>										
Subsidies										
Other operating revenue										
<b>E. Other operating costs</b>										
<b>F. Operating profit (loss) (C + D - E)</b>										
<b>G. Financial revenue</b>										
<b>H. Financial costs</b>										
<b>I. Gross profit (loss) (F + G - H)</b>										
<b>J. Income tax</b>										
<b>K. Other mandatory deductions from profit</b>										
<b>L. Net profit (loss) (I - J - K)</b>										

Based on the documents of the Marshal's Office in Lodz, [www.rpo.lodzkie.pl](http://www.rpo.lodzkie.pl)

Appendix 3. Cash Flow Forecast												
	Year (n - 2) ....	Year (n - 1) ....	Current period ....	Year n ....	Year (n + 1) ....	Year (n + 2) ....	Year (n + 3) ....	Year (n + 4) ....	Year (n + 5) ....	Year (n + 7) ....	Year (n + 8) ....	Year (n + ...) ....
<b>A. Cash flow in operating activities</b>												
1. Net profit (loss)												
2. Depreciation												
3. Changes in inventory												
4. Changes in receivables												
5. Changes in short-term liabilities except borrowings and loans												
6. Other adjustments												
I. Total (1 + 2 + 3 + 4 + 5 + 6)												
<b>B. Cash flow in investments</b>												
1. Fixed assets sold												
2. Fixed assets purchased												
3. Other												
II. Total (1 + 2 + 3)												
<b>C. Cash flow in financial operations</b>												
1. Loans and borrowings received												
2. Loans and borrowings paid back												
3. Subsidies												
4. Owners' withdrawal												
5. Cash paid in by owners												
6. Other												
III. Total (1 + 2 + 3 + 4 + 5 + 6)												
<b>D. Total net cash flow (I + II + III)</b>												
<b>F. Cash position (beginning of month)</b>												
<b>G. Cash position (end of month) (F + D)</b>												

Based on the documents of the Marshal's Office in Lodz, [www.rpo.lodzkie.pl](http://www.rpo.lodzkie.pl)



# Chapter 3

## Foreign market research

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### 3.1. Notion

To discuss the subject of market research, we need to start by explaining the notion of the market as it has at least a number of interpretations. For the purpose of this chapter, the market will be understood as a collection of all buyers and sellers whose mutually dependent decisions shape demand, supply and prices (Lubiński 2002, p. 21).

According to the American Marketing Association, market (marketing) research consists of activities that connect an organisation with its market environment through information. This information is used to identify and specify problems and marketing opportunities, to instigate innovation and evaluate marketing activities, monitor their effects and get better acquainted with marketing processes (Kotler 2002, p. 361). However, there is a shorter and more often used definition of market (marketing) research, according to which it is a process of systematic designing, collecting, processing and analysing data useful in the marketing management of an organisation.

In literature, the notion of market research is used side by side with the term marketing research. Their relationships when it comes to lexical semantics are differently presented and often market research is treated narrowly as a part of a broader notion of marketing research. More recent studies define market research as being synonymous with marketing research (Doman, Denison, Doman 2005; Hague 2006; Kaniewska-Sęba, Leszczynski, Pilarczyk, 2006) and this is how we will interpret them in this chapter. Sometimes, a distinction is drawn between market research and market analysis, this division is based on certain criteria and often it is not clear-cut. In this chapter we will be using both terms interchangeably.

Market research is a tool that supports the marketing decision making process in enterprises. These decisions concern both the market and meeting consumer needs, and that is what market research is primarily used for. Economic decisions are usually taken under conditions of uncertainty, and although market research usually does not completely eliminate the risk of taking an incorrect decision, it certainly reduces it. Market research is used to take concrete decisions, which means that its goal is to provide necessary information. Hence, rarely do we examine all market components, since, as a rule, the research focuses on a particular issue, and its scope and detail depend on the needs of decision makers. Identifying the scope of information and its detail is an important but often very difficult task (Hermaniuk 2005, p. 11).

Depending on the types of decisions made by an enterprise, we can distinguish three types of market research that support them (Churchill 2002, p. 24):

- a) market research that provides information about the environment used for planning decisions – it identifies desirable directions of future market activities, helps in identifying marketing goals,
- b) market research used to solve concrete problems – by identifying root causes of unfavourable phenomena, it enables the implementation of effective corrective measures,
- c) follow-up market research – verifies an enterprise's information, opinions, perceptions of the market and its position in it, which may provide grounds for maintaining or changing previously taken decisions.

From the point of view of the research subject, market research can be divided into:

- a) structural,
- b) cyclical,
- c) marketing – mix components.

Market research should be systematic, i.e., conducted in an orderly way, following a specific plan and repeated at regular time intervals. This is relevant since the collected data gradually become outdated. Only

regularly performed market research allows the collection of exhaustive information indispensable in making business decisions. For example, in the apparel sector, owing to changes in fashion and market seasonality, market research is usually conducted twice a year. Systematic market research also means that it is not "art for art's sake" and it must be used regularly, especially within marketing information flow systems in an enterprise. Some market research may be conducted once only, when it is designed as an aid to take strategic decisions which are made rarely but impact an enterprise's market position over a longer-term. We mean here mainly investment decisions and decisions on a more lasting engagement in a particular market. Such market research is referred to as so called ad hoc research.

Market research should be objective, meaning it should describe the reality in an impartial manner, independently of the convictions, prejudices, and beliefs of decision makers in the enterprise. Only then may it provide the basis for making the correct decisions.

Since, in accordance with the definition, market research is a process of collecting, analysing and interpreting data it must fulfil three fundamental tasks:

- 1) identify market characteristics and structure,
- 2) prepare market diagnosis, i.e., explain why the market has certain features,
- 3) foresee the direction of market changes.

By collecting data we usually obtain only basic information about the market, its features and structure, in line with research goals. Data processing using various (mainly statistical) methods enables the expansion of and a more in-depth analysis by showing the linkages and diagnosis of existing situations.

Based on the situation on the market in question, the research presents predictions of its future development. It formulates assessments and forecasts, together with opinions and statements of experts in the field. This is the key part for the management team, as it shows the future included within the horizon of future decisions. It does not mean, however, that this is the only goal of market research. The analysis of the current state of the market is also relevant for the following three reasons:

- 1) many parameters covered by the research change slowly, e.g., demographic structure, certain habits and likes,
- 2) market analysis helps recognise features, structure and mechanisms contributing to better decisions making,
- 3) knowledge about the market and analysis of past decisions may help avoid wrong decisions in the future.

### 3.2. Characteristics

Market research is classified according to different criteria. From the point of view of geographical scope, we can distinguish national and international research, which are both similar and diverse.

Goals, research methods and tools are the same in international and national market research. In principle, both analyses focus on the same aspects of the market, nevertheless, there are differences, due to a variety of reasons (Czinkota, Ronkainen, 2004, pp. 188–189, [in:] Wiktor, Oczkowska, Żbikowska, 2008, pp. 156–157).

Firstly, international research is expanded with new components which are not analysed for domestic markets, e.g., cultural aspects or geographical environments. Secondly, how an enterprise operates abroad may differ from its conduct in the domestic market, which is why it needs to redefine rules followed at home as it faces a new legal and cultural environment that must be examined. Thirdly, when entering a foreign market a business must expect more intense competition and the need to become familiar with a greater population of competing companies.

Due to the above reasons, foreign market research is a much more complex task than domestic market research as:

- a) it is often performed for a larger number of countries,
- b) access to information about foreign markets is more difficult, especially in poorly developed countries, in some countries data are covered with confidentiality clauses,
- c) cultural and language differences between countries make the research more complicated, in particular when we apply the primary method,

- d) primary research implies high costs and is time-consuming,
- e) difficulties should be expected in comparing results for individual countries, as the systems of collecting statistical data are different.

Progressing globalisation and international integration of economies lie at the heart of the increasing interest in foreign market research. These processes favour the internationalisation of economies within which economic operators are involved in economic activities outside their home countries. The contemporary global economy is a complex system, characterised by versatility and uncertainty. To mitigate the risk of making an incorrect decision, vis-à-vis foreign markets, their selection, entry strategy or marketing strategy, it is necessary to have information about the international environment, which may be provided by market research (Wiktor, Oczkowska, Żbikowska 2008, p. 154). Traditionally, foreign markets were only available to large enterprises but nowadays, increasingly often, foreign markets are entered by small and medium-sized enterprises seeking market niches and the possibilities to offer new products to customers with different attitudes and behaviour. In order to be effective, they need information and market research.

Foreign market research can be divided according to different criteria. Depending on whether a particular operator is an exporter or importer, it will be interested in researching markets where it can either sell or buy.

Foreign market research can be classified based on:

- a) geographic,
- b) and product (goods and services) factors.

The above criteria enable the identification of the following formats of market research:

- a) goods (services) – country,
- b) group of goods (services) – country,
- c) goods (services) – group of countries,
- d) group of goods (services) – group of countries.

Foreign market research may also be divided based on different criteria:

- a) scope of research, full or partial (thematic),
- b) the level of detail – depending on research goal,
- c) the horizon of the study goal – long-term strategic objectives, e.g. to achieve the desired position on the market, short-term goals, e.g. to enter new markets, introduce new product,
- d) marketing decisions, in relation with which it is performed.

The last criterion includes research on (Karcz 2004, pp. 91–100):

- initiating and selecting directions of international expansion,
- selection of form and type of foreign market entry,
- developing marketing action plans,
- and managing international marketing activities.

### **3.3. The role of market research in selecting foreign outlet marketplaces**

Globally, there are more than 200 states which differ when it comes to economic, political, cultural, and other factors. Entering foreign markets follows many patterns. Generally speaking, available strategies are based on a reactive or proactive approach, with the latter including a “narrowing” and “expanding” methodology.

Under the reactive approach, it is a foreign partner who actively seeks and initiates commercial relations. Exports are rather incidental, occasional not systematic. An enterprise which follows this approach conducts very limited international marketing activities and usually is not interested in international market research. When entering a foreign market by following a proactive strategy, an enterprise initiates the selection of foreign markets for its goods (services). This strategy is most effective when applied in a planned and systematic manner, with wide use of international market research. Some exporters apply both approaches:

proactive for their primary markets and reactive for secondary ones (Schroeder, Bartosik–Purgat, Mruk, 2013, pp. 182–185).

“Narrowing”, as used in the proactive approach, starts with a large group of potential outlet markets. At this stage, research is rather general but eliminates the least promising ones. The next step analyses a narrower group of countries in a more detailed way. There may be a few stages of narrowing. In the last one, the target market is carefully examined. In the “expanding” approach, foreign markets are selected based on their similarity to already existing markets, domestic or foreign. In this case, the goal of market research is to find out how similar they are and whether it is possible to formulate a similar marketing programme.

Both methods are designed to collect information (at different levels of detail) on:

- a) business conditions for products from outside a given country (geographic market research),
- b) characteristics of the market of a selected group of goods and services in the country covered by the research (goods and services market research).

### **3.4. Geographic market research**

Geographic market research provides information about a given country from the point of view of the conditions it offers for international economic cooperation. It demonstrates how a market operates, how it is organised and the possibilities for operators from other countries to pursue commercial activities. Based on that, an enterprise is able to assess the investment attractiveness of a particular country, the opportunities and rationale of entering the researched markets and make appropriate decisions to this end. This kind of research does not refer to the goods and services we are interested in. Product research is usually performed separately.

Market research produces a very wide scope of information. From the viewpoint of an entrepreneur who is considering exports or any other form of business internationalisation, data obtained from the research can be divided as follows.

**Table 3.1.** Thematic scope of geographic (country) market research

No.	General area	Detailed subject
1.	Basic country-related data	Geographic location, neighbouring countries, area, population, languages, religions, currency, political system, principal cities
2.	Economic performance	Economic potential, economic and social development, structure of the economy, liberalisation, sustainability
3.	Demographic factors	Birth rate, density of population and geographic distribution, population structure broken down by: urban and rural population, age, education, national and ethnic division, language, religious groups, household sizes
4.	Cultural factors	Attitude to language and religion, consumer habits, aesthetics, attitude to foreign products
5.	Legal regulations	Regulations pertaining to business, including international trade, and their evaluation, stability of business regulations, regulatory compliance, corruption
6.	Technological and technical progress	Level of technological and technical advance, infrastructure
7.	Natural conditions	Climate, landform, access to sea, natural resources, environmental protection

**Source:** Authors' own studies.

Basic country-related data are presented as an introduction. The size and development level of the economy are assessed against Gross National Product, globally and per capita, in current prices and by purchasing power parity. Analysis and forecast of the dynamics of these categories allow the estimation of the potential attractiveness of a country to future exporters. When researching the level of development, besides any economic factors, account should also be taken of social components. Both groups of factors are considered in the UN ranking based on the Human Development Index. Other rankings, e.g., the Quality of Life Index ranking of *The Economist* weekly may also be used.

What needs to be examined is the structure of the economy, with special attention paid to the role of the service, manufacturing and



agricultural sectors, and their major industries. The size and structure of people's incomes and expenses, broken down into groups, characterise consumer demand in a given country and potential import capacity.

Economic liberalization can be synthetically evaluated based on the Index of Economic Freedom ranking of The Wall Street Journal and Heritage Foundation. Other common and simple measures of openness to international markets are exports and imports as a share to GDP. Being party to international economic agreements and integration groupings is relevant for the assessment of the internationalisation of a country's economy.

To an enterprise operating in a given country, analyses of macroeconomic equilibrium, stability and resilience to fluctuations of global business cycles are extremely relevant. To this end, we need to analyse long-term business cycle indicators.

The demographic characteristics of a country are usually stable, their changes occurring slowly, in particular in developed countries, where the birth rate is low. The population structure of a given country (against various criteria) impacts its demand structure. For example, a large share of young people increases demand for entertainment products and services, a large geographical concentration of people facilitates organising an intensive distribution, which is particularly important for selling mass products. There are different demand structure patterns for urban and rural populations, especially in less developed countries, which can be observed, e.g., for food products.

Demographic analysis also provides foundations for market segmentation. In consumer market research demographic criteria, for example age, often provides a basis to distinguish groups of people and identify target markets.

When conducting foreign market research, we need to consider the historical, religious, and geographic conditions that have shaped the culture of a particular country, its behavioural patterns and systems of values, and to learn the directions and pace with which they evolve. An exporter or an investor should know how foreign products from different parts of the world are perceived in a given country. Cultural factors are fundamental when negotiating with a foreign partner, formulating an offer and delivering promotional campaigns.

Those who consider entering a foreign market must carefully analyse the binding regulations in the country in question, especially with respect to foreign enterprises. This will serve as a basis to assess to what

extent and in which areas the law favours or hinders foreign businesses. Stability of regulations and a stable political situation are paramount for economic operations in a country. Frequent changes in economic policy and law are negatively perceived by business circles as impeding economic activities.

Assessment of the regulatory compliance and corruption index are also interesting measures. Synthetic data in this field can be found in the Corruption Perception Index ranking regularly published by Transparency International.

Technical and technological advances are measured based on tools, activities and knowledge connected with the production of goods and provision of services. This may vary across sectors (e.g. there is a high level of defence industry expenditure in Russia). The technical level of an enterprise's offer must be adjusted to the requirements (high or low) in a given country (e.g. in access to electricity). Advanced technical development is reflected in infrastructure – transportation, telecommunications, energy, logistics, social media – which all create conditions for economic operations.

A country's attractiveness also depends on natural conditions. Geographic proximity of potential markets intensifies commercial relations, while access to the sea enables the use of relatively cheap sea transport. The features and parameters of offered products must be adjusted to climatic conditions (e.g. clothing). Landform also impacts the cost of transport. To enterprises seeking supplies in foreign markets, natural resources: raw materials, forests, arable land are relevant characteristics. Exporters are also interested in threats posed by natural disasters, such as floods, droughts, and earthquakes.

The environmental performance of a country, in particular the quality of air, water and soil, can be examined when analysing natural factors. Assessment should also cover the environmental awareness of the population and actions undertaken to prevent environmental degradation.

### **3.5. Goods and services market research**

Goods and services market research may be conducted at different levels of aggregation. We may research an industry, a group of products or just one product, and the latter option is the most common. Bringing researched goods and services together in bigger groups makes sense if they satisfy similar needs, are the effects of a similar production process,

complement or substitute for one another (Lubiński 2020, p. 24). The energy raw materials market is often the subject of research. Product research may cover one or more countries.

For a firm considering the establishment of relationships abroad, product market research is conducted together with geographic market research. Product market research may be conducted by firms already present in a given foreign market which have accumulated some knowledge about the marketplace. Whereas a new entrant needs foreign market research to collect a wide range of information, enterprises already present in a given market are interested in research targeting a concrete issue, e.g., brand perception in a given product group, feasibility of placing a new product in the market, analysis of the terms of wholesale sales.

An enterprise intending to export will focus product market research in a foreign country around the issues presented below.

**Table 3.2.** Thematic scope of product market research

No.	General area	Detailed subject
1.	Market offer	Product range, quality, characteristics, product life cycle stages, after-sales service, warranties, brands, comparison with enterprise's product
2.	Size and structure of the outlet market	Volume and value of sales, structure of sales, potential demand
3.	Commercial policy vis-a-vis a particular product (group of products)	Applied tools – tariffs, non-tariff
4.	Domestic manufacturers	Ranking, information about strategies, competitiveness, sales related data, financial data, relationships among manufacturers
5.	Exporters to a given market	Structure of imports, imports share in meeting needs, profiles of main exporters into the market,
6.	Customers and their segments	Customers' structure, principal market segments, typical customer attitudes and behaviours
7.	Distribution networks	Distribution channels, main distributors, physical distribution
8.	Market prices	Level and structure of prices, sales terms, price elasticity of demand
9.	Types of promotion	Advertising, promotion of sales, direct marketing, public relations

**Source:** Authors' own studies.

Market offer research and its comparison with an enterprise's product should deliver information based on which one will be able to assess whether foreign customers are willing to embrace the offer presented by the enterprise in question. Features of commonly known products are described in brief, while specialist products, e.g., parts used in machines offered to industrial customers or some chemical intermediates, are explained in more detail. Products in the analysed market may be in a different phase of the development cycle than in the internal market (e.g. in some African countries a wound clock or a sewing machine with foot drive continues to enjoy great popularity).

The size of the market should be estimated on two planes. The first one examines product sales in the market, their structure and trends. The second one analyses potential demand – the potential sales achievable if marketing activities are intensified.

Discussion of commercial policy tools applied in a given country to concrete products is a vital component of the analysis. The same can be said about commercial policy tools applied in a particular country, vis-à-vis products covered by the research; in this case, we need to evaluate their efficiency and impact on imports.

Ranking may be helpful in acquiring knowledge about manufacturers from a given country, including foreign investors. Identifying their respective market shares, marketing and competition strategies, strengths and weaknesses is recommended. Data from other fields may also be crucial, e.g., financial performance or supplies. Examining the relationships of major firms with other enterprises in the industry, including trade agreements, may additionally turn out to be important.

Part of the research devoted to imports shows its share in meeting the demand and structure broken down by product groups and geographic areas. Similarly to manufacturers, it is necessary to rank major exporters to a given market and add their characteristics. The importance of a given market in foreign suppliers' strategies should be assessed separately.

Further research focuses on measuring consumer behaviour and attitude vis-à-vis the analysed product. When researching behaviour patterns, we specify where purchases are made, how often, at what intervals, what is purchased, product range, brands, ways of receiving information about products and other factors. Attitudes are defined as positive or negative perceptions of a product, notion or situation (Hilgar 1972 [in:] Kaczmarczyk 1995, p. 149).

Perceptions may include customer expectations, views, convictions, and opinions. They are not always correct but that is irrelevant for the analysis. Research of attitudes that impact purchases covers a very wide range of subjects, including attitude to: manufacturer's country, firms and brands, products, packaging, prices, and distribution channels. Knowing the attitudes is important because they influence behaviour and purchase decisions. If we know them, we can understand the motivation of customers, e.g. the high quality assessment of German vehicles in Poland is an important factor when considering a purchase.

To research customers we need to identify segments, i.e., groups whose members exhibit uniform behaviour and attitudes vis-à-vis the offered products. We need to identify their capacity, behaviour patterns and attitudes, in particular for groups of clients interested in imported products. Based on such analysis, we select a target segment(s). By knowing it, we may develop an offer that meets customer needs, access customers more easily and use this knowledge in promotion activities.

Analysis of distribution helps an enterprise that enters a particular market to become familiar with ways in which products are transferred to the final user. Research focuses on the characteristics of distribution channels, physical distribution or customer service. It analyses distribution systems for products, their mechanisms, complexity, intermediary links and role in product flow. Major distributors need to be characterised in detail. We need to evaluate their distribution strategies, identify strengths, weaknesses and competitiveness. Physical distribution research consists of analysing operations connected with individual stages of business transaction: ordering, transportation, and product storage. Separate research covers the quality of distribution from the point of view of customers' expectations. To analyse distribution, we need quantitative analysis of trade establishments, spatial concentration, degree of saturation, and dynamics of changes.

Information about potentially available characteristics is of key importance to any future exporter as it is decisive for profitability. Analysing competitors' prices, especially foreign ones, in a given market is vital. Such research involves numerous difficulties, due to limited comparability of products offered by various suppliers, prices influenced by a variety of factors, including the scope of offer, linkages between the offering party and the recipient, position in a given market, and price confidentiality. Price estimates of an imported product can be obtained if we know its retail price (for consumer products) and margins charged at different

levels of distribution. Research should also cover terms of sales (trade credit, discount schemes, and others), as they also greatly impact profitability.

Market analysis should identify how far different price levels are approved by individual groups of clients and how sensitive they are to price change. An important, although difficult, element of foreign market research is the identification of the price elasticity of demand for a given product.

Product promotion in a given market is analysed mainly to draw conclusions for future promotion activities. Sales promotions and public relations are relatively uncomplicated, whereas analysing advertisements is much more difficult. Sales promotion research may cover gifts that are gladly granted and received in a given country or a review of fairs and exhibitions from the point of view of an enterprise's needs. Among public relations activities, we may list the research of the image and prestige of journals, research of social perception of participation in charitable activities and sports events. In advertising research we can distinguish the research of content, media selection, and effects (Schroeder 2007, p. 175). For example, once we know the types of advertising existing in a particular market and consumer preferences, we can establish the messages that will impact consumers in a desirable way. Knowing which newspapers and magazines are read by actual and potential clients, we can publish ads there to improve the efficiency and lower the costs of reaching our target groups. Analysis of advertising efficiency is an important component of promotion research. However, the task is complex and difficult, in particular with respect to advertisements or commercials, which have not yet been published.

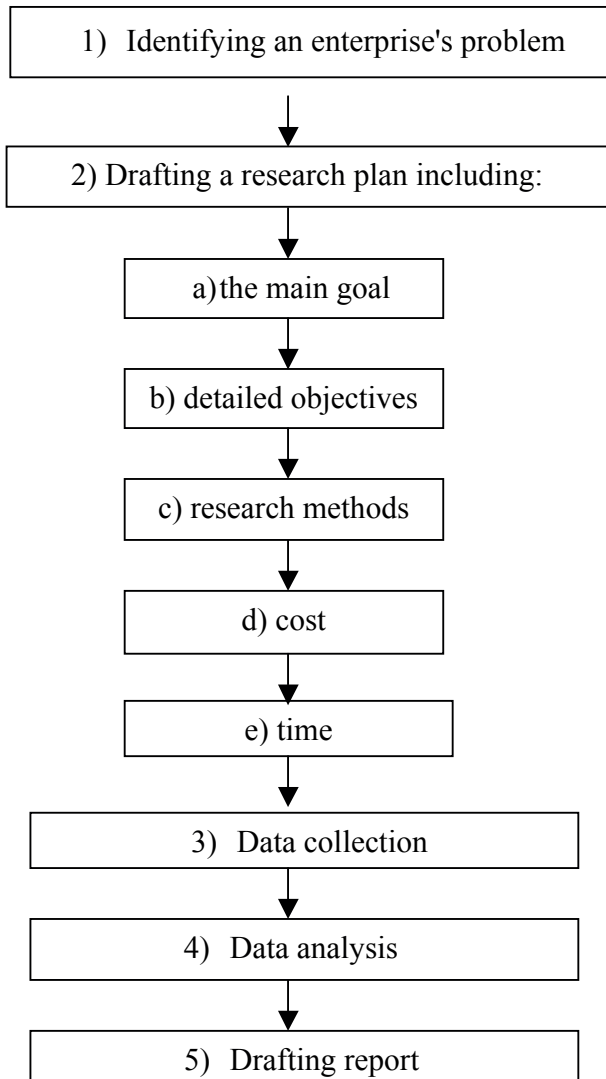
### **3.6. Stages of foreign market research**

In accordance with the definition, market research must be delivered systematically. We can identify the following stages (for both domestic and foreign markets):

When conducting research, we need to stick to the above outlined sequence of steps.

The research starts with investigating a concrete situation of an enterprise to identify the problems it faces – e.g., decreasing sales, obsolete offer, emergence of new technology – which can be solved by taking an appropriate decision. Such a decision can be made once we

have information that can be obtained from research. In order to make a successful decision, the research must be carefully planned. We need to specify its goals connected with the problem. Research studies conducted without clearly stated goal are not particularly helpful.



**Figure 3.1.** Stages of foreign market research

Source: Authors' own studies

Next, we identify the so-called detailed objectives, i.e., the list of data and hypotheses that we wish to acquire or verify to attain the main goal. That brings some discipline into the research and reduces the threat of “drifting away”, which means getting relevant information that does not belong to the goal of the research.

Further, we stipulate the methods that will enable the acquisition of the required information and data. The methodology for this is discussed in the following section. The scope of information expected from research may be reduced due to financial reasons, as information is costly. To calculate the research budget, we may follow two approaches: make it dependent on available funds or on the research goal. The first method usually prevails in practice. If anticipated expenses are too high compared to the funds available for the research, the following options are available: adjustment of the goal, reduce the scope of information to be collected, use cheaper research methods or (an extreme measure) give up on the research. Companies considering entering foreign markets in many countries receive government support through appropriate programs in which market research is financed. This reduces the costs for companies wishing to conduct them. Research should be properly time-framed leaving enough time to develop the plan.

Collected data must be duly processed and prepared for analytical work. In analyses we usually use advanced statistical methods. Work is completed by drafting a report composed of three basic parts: introduction, analysis, and conclusions. The first part specifies the goal of the research, the reason why it is conducted, the methodology, and problems faced throughout its course. The second presents the obtained results and the third the conclusions, highlighting their practical (business) aspects that translate into the solution of the problems faced by the enterprise. The report should be accompanied by a synthetic executive summary, making it easier for decision makers to read through the final conclusions.

### 3.7. Research methods

There are two basic market research methods:

- 1) **primary** – where information is gathered directly from the market; observations and interviews are examples of such techniques.
- 2) **secondary (document based)** – consisting of gathering secondary data, i.e. data previously collected and processed.



Secondary market research uses data and information available within an enterprise (internal) or from external resources. Internal data include all sorts of documents connected with sales – invoices, client information, correspondence, data from foreign representatives, reports from business trips, etc. Information from external resources can be obtained in a traditional way or via the Internet, mainly in the form of statistical documents, descriptions, and lists.

**Compared to primary market research, secondary techniques represent the following advantages:**

- a) they enable research to be conducted relatively quickly,
- b) their cost is usually lower than that of primary research,
- c) easier interpretation of results (by using conclusions from source materials),
- d) some issues can be researched only by using secondary methods (e.g., basic information about a country and its economy).

**Weaknesses of secondary research methods include:**

- a) reduced scope of research as some issues cannot be investigated this way (e.g., opinions),
- b) often too few detailed results,
- c) limited accuracy of available materials – in secondary research we use existing data that has been processed with various goals in mind, not necessarily connected with the goals of this particular research, hence, they may not fully meet our needs,
- d) limited access to existing resources,
- e) limited comparability of data coming from different sources,
- f) limited validity,
- g) limited credibility – this is mainly true of data describing the economic performance of less developed countries.

The issue of access to market-related data differs across countries. The general view is that access to information is most difficult in the least developed countries, e.g., in the European Union such difficulties are marginal, whereas some poorly developed economies do not have basic data that could provide the starting point for further analyses. Another problem may be the high cost of access, their doubtful validity or credibility. Countries may also apply different units, e.g., weights and measures, different age brackets or a different calculation methodology, which makes comparisons a real challenge. Individual sources may give divergent figures on different sizes, e.g. the market, the degree of affluence. In such a situation, it is essential to compare the methodology of calculation, because its diversity is the most common cause of discrepancies.

Foreign market research can be performed using only secondary methods (e.g., to describe a market of a particular country) or secondary techniques may be used in the first part as a basis for further effective primary research, a better understanding of a problem and more precise formulation of goals. Starting research with secondary techniques allows for more in-depth conclusions from primary research methods. Other advantages of secondary methods used in the first part of market research are explored by Kaniewska-Sęba, Leszczyński, Pilarczyk (2006, p. 56):

- a) information and data from secondary research can be the starting point for further research ideas,
- b) they help develop questionnaires used in primary research (e.g., terminology),
- c) they identify sample size and structure.

Secondary study is particularly useful in the case of a market about which we know nothing. In this case, it is necessary at the beginning of work to become familiar with the existing reports on the target country/market. In this way we can obtain a basis for further investigation using the secondary or primary study method.

In primary research, data are gathered directly from the market as a result of interviews and observations. Primary research delivers all sorts of up to date information at different levels of detail, including views, opinions and motivation. However, its application in foreign market research is limited. Conducting a series of interviews abroad is both

difficult and costly. In some countries, questionnaire-based studies must be approved by competent authorities or some works must be subcontracted to local firms, whose work quality may be doubtful. The costs of conducting interviews abroad may be reduced through the use of modern communication technologies, particularly the Internet.

From the wide choice of interview types, open-ended, in-depth interviews better suit foreign market research. Answers are received from respondents well familiar with the market or with its specific aspect. Such an interview is a source of many valuable pieces of information on how respondents perceive the issue at hand. This information is especially valuable when a researcher has little knowledge about the subject of entry into a foreign market (Hague, Hague, Morgan 2005, p. 64). A weakness of such methodology applied to foreign markets lies in the need to find knowledgeable experts willing to share their knowledge.

Observation is a separate primary market research method. It is relatively cheap and provides credible information about how consumers behave. However, it does not inform about attitudes, i.e., the reasons behind particular behaviour patterns. Observation can be overt or covert, conducted in natural or artificial settings, active and passive. Structured observation is guided by a precisely formulated goal, which helps specify the subject of an observation. Otherwise, we are dealing with unstructured observation.

Observation may focus on the following (Jemielniak 2012, pp. 44–46):

- a) organisation of time and space, e.g., pace of activities, climate,
- b) objects, e.g., equipment, labelling, offer,
- c) social actors and their interactions, e.g., groups of clients, conversational patterns.

Among all primary methods, observation is the one most often applied to foreign market research, being particularly popular with smaller economic operators as it is relatively cheap and does not require any engagement in conversations in a foreign language. In retail market research, it focuses on goods on offer – range, packaging, prices, additional information, people's behaviour while looking at shelves in stores (observation in stores). Observation of fair and exhibition stands and visitors' interest in them is also useful in industrial markets.

“Mystery shopping” (mystery consumer, secret shopper) is a specific method of observation. It involves purchasing a product and providing detailed feedback of any experiences connected with the task. This method is widely used for control purposes, especially in services, mainly retail, hotel and catering sectors.

### 3.8. Sources of information about foreign markets

In research based on secondary techniques we need access to input data. This is especially important to operators considering export activities, since their internal data resources are usually limited. External sources used in secondary (document based) research include (Dayan 1999, pp. 17–18):

- a) international public or quasi-public resources – international organisations, representation offices abroad,
- b) domestic public and quasi-public resources – broadly understood administration,
- c) private sources – sectoral organisations, specialist journals, directories, private organisations that collect and organise data (databanks) for sale.

Many international organisations and institutions publish statistical data and reports in selected areas. These are sources of valuable data for market research. Publications of the following bodies are particularly useful: The United Nations Organisation (UN) and its agencies including the International Monetary Fund (IMF) and the Food and Agriculture Organisation of the United Nations (FAO), the Organisation for Economic Cooperation and Development (OECD), the World Bank (WB), Eurostat (Statistical Office of the European Union), and the International Trade Centre agency.

Government agencies make available data relating to their country and to foreign countries, statistical reports, legal acts, thematic reports, also concerning macroeconomic performance and individual industries, plans, programmes and forecasts.

Market data are also collected by chambers of commerce and producers’ associations. Each industry has its own international association or organisation. Most of them limit their activities to analytical studies,

although others try to influence the market. International producers' organisations are, e.g.,: OPEC, bringing together certain major oil exporters, the International Copper Study Group (ICSG), the International Coffee Organisation (ICO), and Organisation Internationale des Constructeurs d'Automobiles (the International Organisation of Motor Vehicle Manufacturers) (OICA). There are also domestic producers' organisations. For reasons pertaining to competition, their documents are, in most cases, available solely to their members.

Detailed information can be obtained by ordering reports from international market research agencies. Some of these conduct systematic research which they make available on a commercial basis, e.g., Nielsen, Marketresearch, Market Publishers.

In Poland, market research is conducted, inter alia, by the Institute for Market, Consumption and Business Cycle Research, the Polish Chamber of Commerce, business intelligence agencies, and consulting companies. Valuable information about foreign markets is also published in specialist magazines and catalogues available on the Internet or as hard copies.

Valuable information can be obtained from the numerous Internet publications and traditional statistical offices of individual countries (in Poland, the Central Statistical Office). Information about markets can also be obtained via specialized offices of the diplomatic missions of their country.

The European Society for Opinion and Marketing Research (ESOMAR) facilitates an on-going dialogue with its 4,900 members, in over 130 countries, through the promotion of a comprehensive programme of industry specific and thematic conferences, publications and best practice guidelines. ESOMAR also provides ethical guidance and actively promotes self-regulation in partnership with a number of associations across the globe.

Nowadays, the Internet is a common access tool to necessary data. In studies of foreign markets, the Internet has become an essential tool, an essential source of commonly used information. Its resources contain reports, papers, catalogues and numerous data. The Internet has revolutionised the provision of information, by giving quick access to huge amounts of valid data at a small cost. However, it has its limitations: data come from various sources of different credibility and only general or fragmented data are available for free, while you must pay for more detailed content. Moreover, finding one specific piece of information in

the sea of billions of publicly available pages could be, despite the existence of efficient search engines, difficult.

### Questions and assignments

1. What is the purpose of foreign market research?
2. What are the characteristics of foreign market research?
3. What are the differences between geographical market research and product and services market research?
4. Describe the stages of foreign market research.
5. What methods are applied in foreign market research?
6. Why is observation particularly useful in the study of a foreign market?
7. What are the advantages and disadvantages of secondary study in relation to primary study of foreign markets?
8. Evaluate the importance of the Internet in the study of foreign markets.

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# Chapter 4

## International business transactions

Bogdan Buczkowski

### 4.1. Foreign market entry modes

In today's global economy, international business offers better development opportunities and greater possibilities to make profits to enterprises than business activities run solely on the domestic market, although at the same time enterprises take greater risks related to running their business activities.

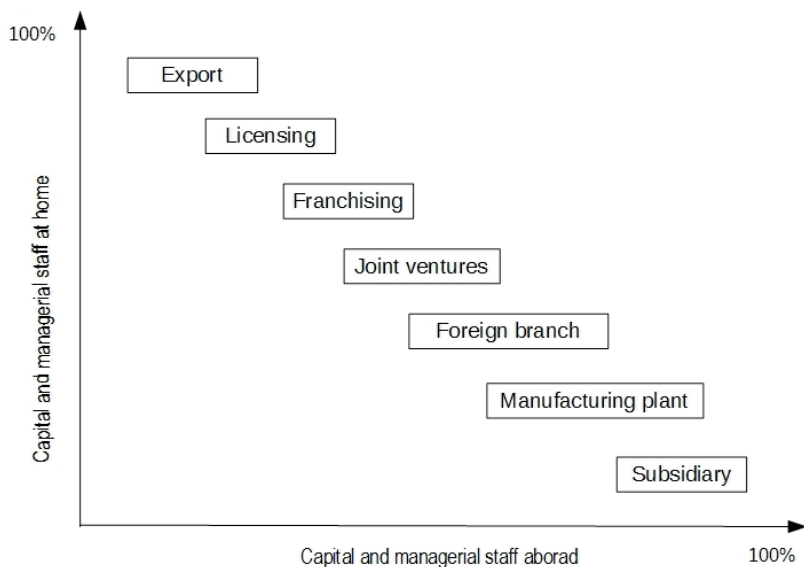
From the point of view of the degree of involving the company's resources, the modes of expansion can be divided into the following groups:

1. Foreign trade;
2. Non-capital co-operation forms;
3. Capital cooperation forms.

Alongside their growing experience, companies gradually progress from the forms that require less involvement of their resources to more advanced forms (Figure 4.1).

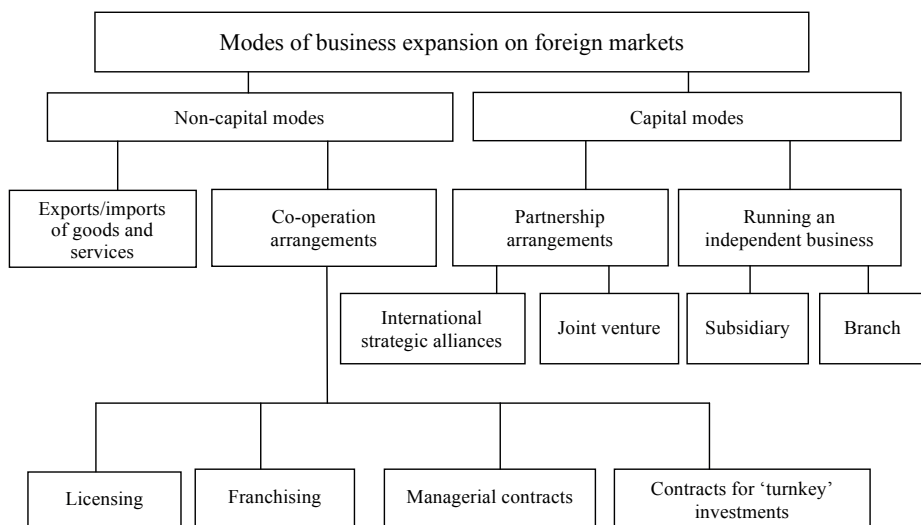
The success of an enterprise starting its internationalisation process depends largely on the accuracy of decisions made as to the choice of the mode of entry into foreign markets, forms of business organisation, capability of maintaining comparative advantages, but also on the maturity of international organisational structures. The choice of the mode of entry into a foreign market is a decisive factor affecting the future functioning of a business, the degree of its independence and the amount of capital involved





**Figure 4.1.** Phases of the internationalisation process of a firm

Source: Author's study based on <http://www.exporter.pl>



**Figure 4.2.** Modes of international business expansion

Source: Author's study based on: Gorynia, 2000, p. 52

Modes of business expansion can be also divided into four groups (Figure 4.2):

1. Imports/exports of goods and services;
2. Cooperation arrangements – licensing, franchising, managerial contracts, contracts for ‘turnkey’ investments;
3. Partnership agreements in the form of strategic alliances or joint ventures;
4. Running an independent business by foreign direct investment – establishment of subsidiaries or branches.

#### 4.1.1. Non-capital forms of operating on the international market

The basic forms of international trade are: import, export and transit commerce, but there are also some specific forms such as counter trade or inward and outward processing and repair transactions. One shared feature of these forms of trade is that they take place on the free market and directly between producers and recipients or by specialised foreign trade companies acting as intermediaries. Part of the transactions are concluded at organised markets, such as fairs, stock markets, auctions, tenders or customs free areas.

**Indirect export**, which usually constitutes the first phase of a company’s foreign expansion, consists in the sales of goods abroad from the country of the exporter via independent intermediaries (Table 4.1). The cooperation between the producer and the export intermediary usually takes two forms:

1. The producer selects a foreign trading company and orders the sale of his/her goods on a foreign market, granting to the trading company the exclusive right to sell,
2. The trading company uses the current offer of the producer.

Commercial intermediaries differ from one another, depending on the type of risk they take. According to this criterion we can distinguish the intermediaries operating:

- for the account and in the name of the principal (exclusive or non-exclusive agent, del credere agent, general agent), CIF-agent, trade broker;

- for the account of the principal and in his/her own name: commission agent, consignee;
- for his/her own account and in his/her own name: distributor, merchant (dealer) who, by taking on the full costs and risk of export operations, benefits in full from the profits made, although he/she is also exposed to any potential loss.

**Direct export** is most often involved in the case of trading in investment goods as well as in highly individualised goods, produced under specialised contracts, where all elements of a transaction need to be agreed with the foreign recipient.

Direct export operations can be handled by (Table 4.1):

- home offices or exports department,
- foreign sales departments or subsidiaries,
- commercial travellers,
- foreign agents or distributors,
- the Internet.

**Table 4.1.** Types and role of intermediaries in direct and indirect export

Indirect export	
Export house	Purchases the goods from other companies and sells them abroad for his own account.
Intermediary of the foreign buyer (confirming house)	Acts on the request of a foreign buyer, who remits an appropriate margin for the purchasing services; the intermediary guarantees to the seller the payment at the moment of the delivery of goods.
Buying houses	Act on behalf of the client, often a foreign department store, for whom the purchase from local producers is made.
Piggybacking	Sales of goods with the use of the distribution network of another, usually large, company.

Direct export	
Agent	Sells in the name and for the account of the exporter, receiving an appropriate margin in return for the services; an agent may sell the goods of one or more, sometimes rival, companies.
Distributor	Sells in his/her own name and his/her income draws from the difference between the purchase and the sales price of given merchandise.
Direct sales	Sales representatives (salespersons) acting on both domestic and foreign markets
Trade representation	An organisation employs its own or local personnel to operate on a foreign market.

**Source:** Author's study based on Fonfara, Ciesielski, 1999, p. 14.

**Co-operative exporting** is among the indirect forms of export in which the exporter co-operates with one or more domestic or foreign companies since he/she cannot operate on the foreign markets on his/her own, due to a lack of sufficient capital and staff or appropriate competences. In order to achieve common goals through export activities, the co-operating companies pool together their resources and share both the risk and the cost of joint operations. The co-operation of producers-exporters may take the form of a group of exporters or piggy-backing – an arrangement in which usually a big company allows a small one to use its distribution network to sell products/services that are complementary to its own products (or at least do not compete with them) and appeal to the same customers. The small firm, benefiting from the extensive sales network and brand image of the larger company, exports its products/services at lower risk and lower costs, including logistics and administration. The big firm, thanks to this cooperation, enriches the range and scale of its sales, as well as quickly recovers a part of the capital invested in the creation of the distribution network. Sometimes a big firm also uses the distribution network of a small one.

A characteristic feature of **transit trade** is the fact that it does not take place directly between the exporter, from the country where the goods originate, and the importer, based in the destination country, but via a transit company based in a third country. Such trade may result from compensation transactions, or producers' and/or recipients' poor

knowledge of foreign markets. The reasons may also be trade protectionism or political motivations. Transit trade may take either direct or indirect forms, also called direct or indirect re-export.

The use of **counter trade** may result from payment difficulties between parties to foreign trade transactions and can take the form of barter, compensation buying, buy-back or offset. In **barter** transactions, no money is used, since the transaction essentially concerns the exchange of goods in kind – goods are simply exchanged for other goods of the same value.

In the case of **compensation transactions**, exporters undertake commitments to buy certain goods or services from importers. There are two transactions, not necessarily equivalent, implemented and financed individually, and the time of their execution can be relatively long.

**Buy-back transactions** are most often found in the exchange of investment goods. The exporter undertakes to buy from the importer the goods produced with the use of machines, equipment or other investment goods that the exporter previously delivered.

Among **offset transactions** we find high value long-term transactions (lasting even as long as 30 years). They differ as to the role of the state in the process of implementing trading arrangements and the degree of the functional link between the compensation goods and the goods delivered within the main (primary) export transaction. Whereas in buy-back transactions, the delivery of machines and equipment is paid back with the goods produced with the use of this equipment, in the case of offset arrangements, the compensation goods or services quite often go beyond the scope of the primary export transaction (indirect offset). Most often, the exporter undertakes to put into operation in the importer's country the licensed production of certain goods, or to purchase (or find a buyer for) certain goods designated by the importer, or to contribute shares in a selected company or to conclude a subcontracting arrangement with a designated economic entity in the importer's country.

A close connection between compensation goods and services and the exported product characterises **direct offset**, usually found in the military, construction and energy sectors. Conversely, in indirect offset, the commitments and liabilities do not have a direct association with the export project implemented: they involve rather the activities aimed at improving the economic situation of the country purchasing the technologically advanced goods. Offset transactions usually involve

concluding several contracts. Next to the main export contract (for armament, aircrafts, power units), the essential offset (compensation) contract between the government and the exporter is concluded. The compensation contract stipulates the scope and value of the offsetting activities to be implemented in the importer country's territory or in the territory of other countries, together with entrepreneurs from the importer's country. Both contracts are usually concluded at the same time.

**Licence** sale is a form of entry into a foreign market in which the right to profit-making exploitation of intangible assets, which are subject to patent or industrial designs protection, is granted to the buyer in return for a one-time or continuous licence fee (royalties). Assets traded under licence sales are technical, organisational or technological solutions, models and designs, brands, trademarks or know-how (which is also an intangible industrial asset, however, one which does not fall under patent or registration protection). When it comes to liabilities on the side of the licensor, we can distinguish between pure (patent) and mixed (complex) licensing transactions. As far as the scope of rights granted is concerned, we can name full or partial transactions as well as exclusive and non-exclusive ones (including full exclusive and non-exclusive partial ones).

**Franchising**, which is a wider form of internationalisation than mere licensing and as such covers all type of licensing relationships, usually takes the form of product and trade name franchising as well as business format package franchising. While under licensing transactions only some elements of the business (brand, trade mark, industrial design or technology) are the subject of the transaction, in franchising agreements (in particular in package franchising) the franchiser grants to the franchisee – in return for financial remuneration – the right to use the complex business operation model. Contract of that kind are found mainly in the services and trade sectors.

The essence of **contract manufacturing** abroad consists in concluding with a local producer an agreement for manufacturing and servicing of products (according to the specifications provided), with the right to decide about sales, pricing, distribution and marketing left in the hands of the principal.

**Subcontracting and original equipment manufacturing** contracts are among the export-import type of transactions, since they consist in providing the contractor with components for the manufacturing of final goods intended for sales on a given market.

**Managerial contracts** constitute a form of international activities of enterprises consisting in the provision of company management services by a team of appropriately knowledgeable and experienced personnel. This managerial team, however, cannot undertake any commitments or make key decisions related to the company managed without prior permission of the principal.

**Turnkey investment contracts** (concerning complex investments) constitute a specialised category of managerial contracts and at the same time they are among the most advanced, complicated and risk-charged non-capital forms of internationalisation.

#### **4.1.2. Forms of operating on the international market with capital involvement**

A **joint venture** is a capital form of operation on a foreign market, which consists in establishing a company with the participation of an independent foreign partner. The shareholders bring into the company contributions in kind, financial resources, know-how or knowledge of local markets and the domestic regulations in force. The contributions of foreign partners are usually: capital, brand and technology, while local partners usually bring in: local staff, land, local contacts, distribution networks and other resources. Thus, the resources of both parties are involved and the risk and rewards involved in a joint enterprise are shared. The chances of success are larger when the shares and contributions of both partners are similar and where there are no substantive differences in opinions, systems of values and the methods of operation.

From the point of view of the size of partner share, joint ventures may be divided into majority, minority and parity joint ventures. In turn, as far as the market sectors are concerned, we can distinguish commercial, manufacturing or service joint ventures, while the roles the partners play in the production and distribution chain determines the division of joint ventures between vertical ones (enterprises belong to different levels) or horizontal ones (the partners are from the same level). Joint ventures can be formed for indefinite or definite periods of time, i.e. for the execution of a particular project only.

**Strategic alliances** are voluntary business cooperative agreements, concluded between both competing and non-rivalling companies. Among the alliances of non-rivalling enterprises, we find **vertical partnerships**, established by companies from different levels of the distribution

channel, which operate on the basis of the provider-recipient relationship. **Intersectoral agreements** are concluded between the companies involved in entirely different activities with no provider-recipient relationship between them. **Multinational joint ventures** are such forms of co-operation in which one of the partners disposes of an attractive product while the other one offers access to the desired markets.

The alliances formed by competing companies include:

- **complementary alliances**, whereby co-operation takes place between the producers of goods intended for similar use and it aims at a more efficient exploitation of the functions these goods already possess,
- **integrating alliances**, formed for the joint production of some elements that are later used separately by each of the partners,
- **additive alliances**, which consist in co-operation aimed at the joint manufacturing of a single product, in consequence leading to the suspension of competition between the partners.

Among the strategic alliances we can also distinguish **manufacturing, distribution, research and development alliances** or **consortia**, which are close in nature to joint ventures.

**Foreign direct investments** (FDI) constitute a form of running independent operations abroad, which consists in establishing subsidiaries or branches and represent the most capital-intensive and risk-charged mode of entry into a foreign market. They can be created either by the purchase (take-over) of an already existing company operating in a given sector (brownfield investment), or by establishing a new company (greenfield investments). A new entity can be a **direct branch**, a **wholly-owned subsidiary** or a **joint venture**. The basic difference between a branch and a foreign subsidiary is that a branch is subject to the law of the country of origin and constitutes an integral part of the mother company, which bears the full responsibility for branch operations. A subsidiary, in turn, has its own legal personality and is a separate unit, operating under the law of the host country.

Companies usually undertake various measures to reduce the risk of international business transactions. Appropriately formulated agreements and contracts constitute the principal and most commonly used tool for minimising these risks.



## 4.2. Preparation and conclusion of commercial transactions

### 4.2.1. Inquiries, offers, orders and contracts

An entrepreneur who intends to find a contractor formulates an **inquiry**, usually in the form of a commercial letter, and sends it out by post, fax, e-mail, or sometimes even via SMS or MMS, to selected companies. The purpose of the inquiry, which does not involve any legal consequences for the parties, is inviting the addressee to submit an offer to sell given goods or services.

An **offer** (also a bid or tender) is a binding proposal to purchase/sell merchandise or to provide services (or both), which specifies explicitly the definite terms of the future sales/purchase contract. Submitting a non-binding offer is also possible, but its non-binding nature must be clearly stated in the document. An offer submitted following an inquiry is a solicited offer or bid, while an offer sent on the initiative of the seller, without prior inquiry, constitutes an unsolicited offer/bid.

The **acceptance of the offer** by the offeree should be full and unconditional as only such an acceptance is binding for the bidder. This acceptance can take the form of **placing an order**, by which the sender gives his/her approval to conclude the export/import contract, under conditions previously agreed with the partner. The acceptance of the offer without reservations, e.g. in the form of an **order confirmation**, means that a contract has been concluded. The contract can also be concluded by further specification of the offer as a result of negotiations with subsequent confirmation of this clarified offer by the seller, or in the form of a single legal document. Such a single legal document, or a **single document contract**, containing all provisions regarding mutual considerations by the parties, may take the form of a standard contract, prepared with the use of a special form/template. However, in foreign trade, **multi-document contracts** are used more often. They result from the exchange of documents (inquiry, offer, acceptance of offer, order placement, order confirmation) between the parties.

Regardless of the way in which a contract is concluded, it should contain certain key elements, known as **standard clauses**, referring to the contractual obligations such as: subject of the contract, the amount of goods or scope of services, pricing, the place of goods or services delivery, delivery terms according to appropriate trading rules (e.g. Incoterms,

Combiterms, RAFTD), the date of delivery, means of transportation and payment terms. The contract may also list **additional clauses/conditions**: e.g. the jurisdiction clause, arbitration clause, revision clause, price review clause, entry into force clause, force majeure clause, re-export prohibition clause, liquidated damages clause or complaint clause. These supplementary conditions can be formulated by one of the parties or recommended by professional organisations, chambers of commerce as well as state or international authorities. The inherent parts of the contract are also appendices of various kinds, including: description of technical conditions, specifications, instructions concerning packaging, labelling or loading, etc.

#### 4.2.2. Law applicable to the contract

By law applicable to the contract we mean the law which governs the contractual arrangements between the parties and to which the parties and courts refer in case of disputes arising under the contract. The choice of the applicable law exerts its influence on a number of key elements of the contract, both at the stage of the contract's formulation and during the implementation phase.

Legislations of the majority of states and international conventions guarantee to the contracting parties a fundamental **right of the freedom of contract** (concluded in good faith and according to the rule of business honesty). The freedom of contract refers to the autonomy in shaping the substantive contents of an agreement, choice of its form (written, oral, electronic, expressed with gesture), language and the law governing the contract. The contractual provisions cannot, however, contravene, under pain of invalidity, public law provisions (fiscal, monetary or related to sanitary norms), and those norms of domestic, international and supranational laws in force which are applicable according to the appropriate provisions of private international law (national laws regulating foreign exchange and applicable by virtue of relevant conflict-of-laws rules of private international law).

The legal capacity of the parties to conclude a contract is determined according to the national law of the country of residence (natural persons) or of the seat of a company. The form of the contract is assessed according to the conflict-of-law rules and usually it is the law of the country where the contract is concluded.

An international contract is thus governed by the law explicitly chosen by the parties, for instance, in the **law of the contract clause**. The selection of the applicable law can also be implicit, yet still must unambiguously result from the provisions of the contract or from the wider context of a given case. The applicable law may be that of the country of one of the parties to the agreement, or the law of a third country. The parties can also choose international commercial law, resulting from international agreements to which one of the countries country is a party. Resolutions by international organisations or systems of sectoral commercial practices and usage, formulated and published by governmental and professional organisations, may also govern the contractual relations between the parties. These customary commercial practices usually overlap with the legal systems of the signatory countries. Among these arrangements we find: UNIDROIT Principles of International Commercial Contracts, the United Nations Convention on Contracts for the International Sale of Goods (UN CISG), The Principles of European Contract Law (PECL) and Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), replacing the Rome Convention on the Law Applicable to Contractual Obligations.

The parties may choose the applicable law for the entire contract or part of it, for example with the use of the following provision: 'The contract shall be governed by Polish law, with the exception of Article ..., subject to Spanish law' or 'The Contract shall be regulated by UN CISG, except for Art. ...., which, should such a need arise, may be amended in accordance with German law.' The choice of the law applicable does not exclude later changes in this respect, related to both the entire contract and to any part of it.

In the case of parties not having chosen the law of the contract, or when the choice made is ineffective, the determination of the governing law belongs to the authority competent to settle the dispute, according to the rules of private international law (conflict-of-law rules) of the country in which this authority is based<sup>1</sup>.

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<sup>1</sup> In practice, it is usually the country of residence of the defendant or, in the case of an enterprise, the country where the company is registered, conducts its business activities and where its office and its property are based. This is because it is easier to force the defendant to appear before the court than in the case when he/she remains outside this court's jurisdiction.

The law of the country of the seller will be the applicable law, because it is most closely connected with the contract concluded<sup>2</sup>. The law of the country where the dispute takes place, where the contract has been concluded and is implemented, or where the immovable property is located, may be also chosen as the governing law. It can also be the law of the country of the language in which the contract was concluded, whose currency is used in invoicing or payments, or even the law of the country whose flag is flown on the vessel carrying the goods.

The aforementioned conventions and international agreements, providing for the standardisation of laws relating to commercial transaction on international markets, serve the purpose of eliminating the necessity to consider various factors, when decisions as to the applicable laws are taken. International conventions or private international law should apply when decisions as to the choice of the law governing the contracts are taken in the case of contracts concluded with contractors from outside the EU.

Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (known as the Rome I Regulation), provides for the rules applicable to the choice of the law governing contracts concluded between EU contractors. The Regulation is directly applicable in the EU territory and takes precedence over international conventions and domestic laws. Although the principal rule is the freedom of choice of the law applicable, the parties' autonomy is limited to the choice between the laws of designated

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<sup>2</sup> In the case when no choice of EU contracting parties has been made according to the 'Rome I' Regulation, the contract should be governed by the law of the country where the party required to effect the characteristic performance of the contract has his habitual residence. A characteristic performance is such a performance, usually non-pecuniary, which decides the specificity of the contract in question. In the case of a sales contract, the performance is that of the seller, and the contract will be governed by the law of the country in which the seller has the place of habitual residence – the place where the main office is based (Article 19). Similar rules for the designation of the law governing the contract are applied in the case of services contracts as well as those related to distribution, credits or franchising. Different rules apply to contracts relating to rights *in rem* in immovable property or tenancies of such property. These contracts are governed by the law of the country where the property is situated. The 'Rome I' Regulation also provides for specific arrangements concerning specific types of contracts such as: contracts concerning carriage, insurance, voluntary assignment of receivables, individual employment contracts or contracts concluded with consumers. In those cases, regardless of the choice made by the parties, some specific limitations deriving directly from the Regulation apply.

countries, which excludes the possibility of preference being given to the law contained in private codifications: UNIDROIT, Principles of International Commercial Contracts or Principles of European Contract Law.

In short, each contract is subject to its governing law, chosen by the parties to the agreement or – in the absence of the governing law clause in the contract or in the case of ineffectual choice – to the law specified by private international law regulations. International agreements ratified by a given country, constituting an integral part of any domestic legal system, take precedence over the rules established by national laws.

#### **4.2.3. Commercial jurisdiction and enforcement of judgements**

When a dispute under an international sales contract arises, it is important to identify the proper jurisdiction, i.e. the court competent to hear the case. The generally accepted rule provides that judgements given by courts in one country are binding in the territory of this country, while the recognition and enforcement of judgement by courts of other countries depends on whether a national law (bill) or international agreements provide for such a possibility.

The New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards is the principal legal act with international reach in this respect. Under this Convention, the judgements in both civil and commercial cases can be enforced, not only those in the territory of the country-signatory to the Convention. This is because the Convention commits the member states to recognise foreign arbitral awards as binding and to enforce them in accordance with the procedure in force in the state of enforcement. The document also stipulates explicitly the reasons for the refusal of enforcement, transferring the burden of proof to the party against whom the enforcement procedure is invoked.

Under the EU system, the principal legal act that regulates the jurisdiction, recognition and enforcement of judgements is Regulation (EU) no 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (known as Brussels bis), in force since 10.01.2015 [Official Journal of the European Union, L 351/1 of 20.12.2012]. The Regulation is applicable in both civil and commercial cases, regardless of the type of court involved. However, it does not cover the issues of relationships between common courts and arbitration

bodies, and does not apply to arbitration cases, leaving these matters to other international law acts, including the New York Convention. Moreover, the discussed EU Regulation does not cover matters relating to tax, customs and administrative cases, nor the litigation concerning the liability of the State for actions or failure to act in exercising its statutory powers.

Under the 1215/2012 Regulation, an agreement conferring **jurisdiction in international trade** should be concluded in a form which accords with the usage of which the parties are aware, and which they regularly observe (Article 25, 1 (c)), while any communication by electronic means providing a durable record of the agreement is equivalent to a written form. Further, an agreement conferring jurisdiction, which forms part of the main contract, is treated as an agreement independent of other terms of the contract. Therefore, it is not possible to contest the validity of the agreement conferring jurisdiction solely on the grounds that the main contract is not valid.

If, regardless of their domicile, the parties have agreed that the courts of a member state should be competent to settle any disputes which have already arisen or which may arise, these courts should have jurisdiction, unless the agreement – under the law of that member state – is null and void as to its substantial validity. Such jurisdiction is treated as exclusive if the parties have not agreed otherwise. The court designated in the agreement conferring jurisdiction basically takes precedence over other competent courts, regardless of the court to which the case was originally brought. This limits the possibility of bringing cases to courts other than the court designated in the agreement.

If a case is being heard by a court in a third country, i.e. outside the EU territory, a competent court in a member state can suspend the proceedings, taking into account the proceedings pending before a third state's court, if there are justified reasons to expect that a judgment of the third State's court will be capable of being recognised and enforced in the member state in question.

Employees and consumers may sue the employers and entrepreneurs not domiciled in the EU before EU courts, regardless of these employers' or entrepreneurs' domicile or seat. In other cases, including those relating to international trade contracts, the possibility of a lawsuit depends on the defendant's being domiciled in the EU territory.

A judgment given in a member state should be recognised in other member states of the EU, even if it concerns a person not domiciled

in a member state. When a judgement is given in a member state and enforceable in that member state, it should be enforceable in another member state without the need to establish its enforceability. Furthermore, such a judgment may not be reviewed as to its substance in the member state addressed, under any circumstances. A party invoking a judgment given in another member state must provide a copy of the judgment and an appropriate certificate. The court or other competent body before which such a judgment has been invoked may – if necessary – require it to be provided with a translation or a transliteration of the judgment.

In accordance with the procedure provided for in the Regulation, any interested party may apply for a decision that there are no grounds for refusal of a judgement recognition. Moreover, a judgement enforceable by operation of law constitutes the basis to apply any protective measures existing under the law of the member state addressed. Procedures related to the enforcement of judgements given in another member state should also be governed by the law of the member state addressed.

Recognition or enforcement may be refused on application of an interested party, if: a) recognition would be contrary to public order; b) the defendant was not served with the document which instituted the proceedings in sufficient time and in such a way as to enable him/her to arrange for his/her defence; c) the judgment conflicts with a judgment given in another member state or in a third State and involving the same cause of action between the same parties.

The Regulation does not affect the application of the Lugano Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, which entered into force on 1 January 2010 and the aforementioned New York Convention of 1958.

#### **4.2.4. Commercial uses, customs and contractual clauses**

International trade is based to a large extent on commercial practice and usages. Commercial practice means a traditional way of proceeding when concluding a contract, or a widely accepted and uniform way of interpreting the terminology used in commercial exchanges. Its legal value, that is its role, place and scope of application – is defined by the domestic law applicable to a particular contract. It cannot be contradictory with the rules of the law in force: the parties to a contract enjoy the freedom of agreement on, and application of, customary commercial practices,



yet still within the limits of the laws in force. Customary arrangements may only supplement the contractual provisions and must be explicit and widely known in commercial practice or in a particular business sector. Commercial usage is a trade practice officially recognised by a competent body and declared as binding or recommended.

The International Chamber of Commerce (ICC) in Paris is the principal organisation providing standardisation of various commercial practices. It has published a number of documents related to commercial practices used in international transactions settlements, namely: Uniform Customs and Practice for Documentary Credits (UCP 600), Uniform Customs and Practice for Documentary Credits for Electronic Presentation (eUCP), Uniform Rules for Collection (URC522), the Uniform Rules for Demand Guarantees (URDG458), Uniform Rules for Contract Guarantees (DOCDEX 811) and Documentary Instruments Dispute Resolution Expertise. In order to secure the precise definition and common interpretation of the terms and conditions of trade used in the contract, the ICC has published a number of subsequent versions of the International Commercial Terms (Incoterms), with the first version published as early as 1936, and the latest in 2010. They have brought together typical and most commonly used combinations of contractual commitments between buyers and sellers (in particular the costs and risks). When negotiating an international sales contract, the contractors should pay as much attention to the conditions and terms of trade as to the selling price.

**The description of the subject of the contract** should be precise enough to enable its clear identification, for example by a) indication of the trading name or brand of the good, supplemented by the necessary technical data, b) reference to a sample or a design (delivered before the conclusion of the contract and preserved for the purpose of claiming damages), c) a description with accompanying drawings, photographs, documentation and list of technical parameters, d) definition of the merchandise quality determined by the trading name, technical data accompanying the description of the subject of the contract or by appropriate merchandise standards.

**The unit price** of merchandise is expressed in the agreed currency of a contract with possible additional clauses (a valorisation clause or price review clause). The price remains closely related to a **discount**, a percentage reduction in price offered on purchase of a larger tranche of goods. A discount can be also offered to regular clients who refrain from buying competing products (customer discount/loyalty discount) or to



the clients who – in a given period of time – purchased at least a pre-defined amount of goods (volume discount or quantity discount).

**An early payment discount** is a percentage discount that can be granted in the case of cash payment or payment made before the date agreed under the contract. In practice, this discount usually takes the form of an invoice rebate, written down in short on an invoice as e.g. *3/14 net. 30*, meaning that for making a payment within 14 days, the buyer will receive a 3% discount and if the payment is made within 30 days, no interest on late payment will be charged.

**A quality discount** is offered to an importer, either on the exporter's initiative or as a result of a complaint accepted, if the goods delivered are of lower quality than stipulated in the contract. The specific names of these types of discounts evolved gradually in the case of goods subject to natural loss, such as: sticky substance adhering to the packaging – *besemschon*, drying up or shrinking down – *decalo*, liquid leaking out – *leakage*, or *fusti*, meaning the contamination of goods by foreign particles. Quality discounts and compensations are usually not included in the contract, although with regular partners and trade in homogenous goods, transported by the same means and to/from the same destinations, these discounts are provided for in the contract so as to avoid unnecessary costs and inconvenience connected with the discharge of the goods' quantity after their delivery.

**The currency of the contract** in which the price is expressed can be that of either of the parties or of a third country.

**The quantity of goods** is expressed in appropriate units of measurement (tonnes, metres, pieces, pairs, barrels). When the word 'circa' is added before the quantity of goods, it is commonly accepted that the variation amounts to  $\pm 10\%$ , unless the parties have agreed otherwise.

**The date/time of delivery**, that is, the time of implementation of the contractual obligations, can be specified precisely as e.g. 25 October 2015, or only approximately, subject to further clarification. The date of delivery can be expressed in a number of different ways. In transactions providing for instant delivery, the terms *immediately*, *promptly* or *as soon as possible* are used. However, as these terms are not very precise, they can be interpreted in a number of different ways. A delivery date may also mean a designated period within which the delivery of the goods should take place. In that case, the seller can deliver the goods on any day within the period, with customary notification of the forthcoming

delivery required. The period can be specified by use of the following phrases: '*within a quarter ...*', '*between ... (date) and ... (date)*', '*within a month from ...*', '*at the beginning of ... (month)*', meaning between day 1 and 10, '*in the middle of ... (month)*', meaning any day between 11<sup>th</sup> and 20<sup>th</sup> day of the month, '*at the end of ... (month)*', meaning any day after the 16<sup>th</sup>, '*within a month*' – *between the first and last days of a month*. Additionally, *primo* – means delivery within first 10 days of a month, *medio* – 10 middle days, and *ultimo* – last 10 days of a month. Some of the customs and standards have been borrowed from everyday language, for example a.s.a.p. (as soon as possible), which – in maritime transport – means the order to ship the goods by first vessel on which the entire consignment can be loaded, or as soon as the sea route is open. Similarly, *immediately* – means the order to ship by first accessible freight from a given port. The *Loco* formula means the sales of goods to be collected from the place where the goods were stored at the time of the conclusion of the contract, whereas the *Franco* formula means forwarding the goods to the recipient. These terms were commonly used before introduction of Incoterms.

Commercial formulas play an important role in defining the **terms of delivery** (also called delivery base or price formula) which specify whether the goods are to be made available to the buyer at the seller's own premises (group E), forwarded to a carrier or for loading to a means of transport (groups F and C), or delivered to a designated place (group D). As far as customs clearance is concerned, the last two versions of Incoterms provide for the rule that the exports customs clearance is executed by the exporter and the import customs clearance falls under the responsibility of the importer, with the exception of the EXW formula, where customs clearance in both exports and imports belong to the importer, and the DDP formula, where both are executed by the exporter. The seller, regardless of the commercial formula, is obliged to secure appropriate packaging (unless the contract provides otherwise), labelling and to provide evidence confirming that these obligations have been fulfilled. The buyer is obliged to accept – in the named place and at the time agreed – the properly individualised (labelled by the seller) merchandise as the subject of the contract, since from that moment the risk related to the goods passes on to him/her. As the Incoterms do not concern the shipping, banking or insurance arrangements, they do not apply to third parties – carrier, freight forwarder or insurer. An agreement on the use of certain Incoterms formulas contained in the trade contract

may, however, cause implications for other contracts. If, for example, the CFR or CIF formulas are used, the seller cannot use other means of transport than by sea or inland waterways, because a bill of lading (not available in other means of transport) has to be submitted to the buyer. The type of required shipment document, required under the credit transaction, is also conditioned by the means of transport to be used. If, under the letter of credit arrangement, an AWB (Air waybill) is required, the seller may conclude a contract of carriage only with an air carrier.

The Incoterms do not determine issues related to change of ownership, liability waivers relating to unexpected incidents, nor about the consequences of contractual obligations infringements, except for the shift of responsibility in the case when the buyer has not fulfilled his obligation related to the acceptance of delivery or designation of a carrier (group F). The Incoterms require that the seller supply the goods conformant with the contract, but they do not deal with the consequences of the goods being not conformant with the contract. Therefore, in order to be complete and comprehensive, a contract needs to include individually negotiated provisions or standard commercial rules. Table 4.2 presents the division of costs between the seller and the buyer for each of 11 terms in Incoterms (version of 2010)

Division of the risk between the seller and the buyer under Incoterms 2010:

1. **EXW = EX Works** (from the premises, ... a named place) – all means of transport.

The seller's obligations related to delivery are fulfilled when the goods are made available at the seller's premises. The seller is not responsible for loading the goods on the vehicle provided by the buyer.

2. **FCA = Free Carrier** (a named place) – all means of transport.

The seller is obliged to hand the goods over to the carrier (or other person, e.g. freight forwarder) named by the buyer. The costs of shipment, on its main route, are covered by the buyer, who takes over the risk at the moment when the goods have been handed over to the carrier. This formula provides for two options of delivery, depending on the place of handing the goods over to the charge of the carrier:

Table 4.2. Division of costs between the seller and the buyer under Incoterms 2010

Services	EXW	FCA	FAS	FOB	CFR	CIF	CPT	CIP	DAT	DAP	DDP
	Ex Works	Free Carrier	Free Alongside Ship	Free On Board	Cost and Freight	Cost Insurance Freight	Carriage Paid To	Carriage Insurance Paid To	Delivered at Terminal	Delivered at Place	Delivered Duty Paid
Warehouse storage	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Warehouse labour	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Export packing	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Loading charges	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Inland freight	Buyer	Buyer/ Seller*	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Terminal charges	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Forwarder's fees	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Loading on vessel	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Sea/air freight	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Charges on arrival at destination	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller	Buyer	Seller
Duty, taxes and customs clearance	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller
Delivery to destination	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller	Seller

\*There are actually two FCA terms: FCA seller's premises, where the seller is responsible only for loading the goods, and FCA named place of international carrier, where the seller is responsible for inland freight.

Source: Author's study based on Incoterms 2010, ICC, Paris 2011.

- 1) if the delivery takes place on the premises of the seller, it is regarded as being effected when the goods have been loaded on the means of transport provided by the carrier,
- 2) if the place is different from the seller's premises or warehouse (e.g. depot, port), the delivery is deemed to have been effected after handing the goods over to the carrier on the means of transport provided by the seller. The unloading of the goods from the seller's means of transport does not fall under the seller's responsibility. If the place of handing the goods, the carrier or the time of delivery have not been specified by the buyer, or if the carrier has not accepted the goods for any reason, the entire risk for the goods loss of damage passes on to the buyer, on condition that these goods have been appropriately identified as the subject of the contract.

**3. FAS = Free Alongside Ship** (a named port of loading) – transport by sea or inland waterways.

The seller's obligations are fulfilled when the goods have been placed alongside a vessel in a quay at the designated port of loading. The seller is responsible for the exports customs clearance and remittance of the cost related thereof.

**4. FOB = Free On Board** (a named port of loading) – transport by sea or inland waterways.

The seller is responsible for delivery of goods to the carrier named by the buyer. The costs of delivery along the main route are not paid by the seller. The risk of loss or damage is transferred to the buyer when the goods have passed the ship's rail in the port of loading. The seller is responsible for the customs clearance of the goods in exports, while the buyer undertakes all costs of remaining risks related to transportation from the moment the goods are placed on board the ship.

**5. CFR = Cost and Freight** (a named port of destination) – transport by sea or inland waterways; for combined transport, CPT Incoterms are recommended.

The organisation of transport (concluding the contract of carriage) and related costs belong to the seller. The seller is also obliged to

deliver the goods to the carrier, or if there are several of them, to the first carrier in line. From that moment, the risk related to damage is transferred to the buyer. If the buyer wishes to indemnify the goods, the seller is obliged to provide all information necessary to conclude an insurance contract.

6. **CIF = Cost, Insurance and Freight** (a named port of destination) – transport by sea or inland waterways exclusively; for combined transport, CPT Incoterms are recommended.

Under this arrangement, the scope of responsibilities, division of costs and risk is analogous to that under CFR, with further responsibility for concluding the insurance contract and payment of its costs added. The seller must provide the buyer with evidence concerning the insurance of the goods so that the buyer can claim damages from the insurer. The risk of loss or damage is transferred from the seller to the buyer at the moment the goods have passed the ship's rail.

7. **CPT = Carriage Paid To** (a named place of destination) – all means of transport, including combined transport.

The seller is responsible for concluding the contract of carriage to the designated point of delivery and to pay the costs of shipment. He/she is also obliged to deliver the goods to the carrier, or – if there are several carriers involved – to the first of them. From that moment, the risk of the goods' loss or damage is transferred to the buyer. The seller's responsibility is also the clearance of goods in exports.

8. **CIP = Carriage and Insurance Paid To** (a named place of destination) – all means of transport, including combined transport.

Compared to that under the CPT formula, the scope of the seller's responsibility is extended to the obligation to conclude the insurance contract and to pay its costs.

9. **DAP = Delivered at Place** (a named place of destination) – all means of transport.

The seller's obligations are fulfilled when the goods are delivered at the place designated by the buyer. The risks and costs related to delivery, with the exclusion of customs duties, taxes and other charges

due in the buyer's country, are incurred by the seller. The buyer bears the costs of import customs clearance.

**10. DAT = Delivered at Terminal** (a named place) – all means of transport.

The seller's delivery obligations are fulfilled when the goods are delivered and unloaded in the depot. The risk and costs of unloading are borne on the side of the seller, while the costs of import custom clearance are on the side of the buyer.

**11. DDP = Delivered Duty Paid** (a named place of destination) – all means of transport.

The seller's obligations are fulfilled when the goods have been delivered to the place indicated by the buyer. All costs and risks, except for the import customs duties in the country of the buyer, are incurred by the seller. Thus, the seller assumes the largest responsibility, unlike under the EXW formula.

#### 4.2.5. Additional contract clauses

**Conditions and terms of inspection and receipt of goods.** The aim of an inspection is to establish the current status of the contract implementation, while the receipt of the goods makes it possible to check their conformity with the contractual provisions. The check may be performed on one's own, usually by the supplier, or it may take the form of a contracted control, where the procedures are performed by competent organisations. It is also possible that the inspection takes place *ex officio*, and is carried out by state authorities. The costs related to the inspection, depending on the contractual provisions, are incurred by either the seller or the buyer. Where and how the goods are received are negotiated and later specified in the contract.

**A contract validity clause** suspends the contract's entry into force until the conditions agreed upon in the contract are met or required documents are delivered, e.g. *This contract shall enter into force on condition that the exports licence is obtained by the exporter or The contract shall enter into force provided that the opening of the letter of credit shall take place not later than two weeks after the conclusion of the contract.*

A **governing law/law applicable clause**, indicates the law to which the parties, judges or arbitrators refer in case of disputes or conflicts between the parties.

**Force majeure and hardship clauses** are incorporated into the contract in order to protect the parties from events that obstruct or completely exclude the fulfilment of the contractual obligations. Such a clause allows relief from the responsibility for non-performance of the contract by the party affected by circumstances agreed upon in the contract. This clause should contain a list of such conditions, e.g. flooding, industrial action, outbreak of war, revolution, riots, etc. The notion of *Act of God* can also be understood in a wider context and may cover the following: shortages in supplies, transport difficulties and other events hindering the performance of a contract.

**Act of God and hardship.** An Act of God is defined as sudden events against which the parties cannot protect themselves and which hamper or exclude the possibility of fulfilling the undertaken obligations. Act of God circumstances are those which arise after the conclusion of the contract and occurring due to irreversible and extraordinary incidents, unforeseen by the parties. The hardship clause can be referred to as a provision that the contract is in force as long as the relations existing between the parties at the time of the contract conclusion are not fundamentally altered. Such a change of circumstances very often results from *force majeure* occurrence. However, the aim of *rebus sic stantibus* (Latin for *things thus standing*) clauses is usually not to relieve or lessen the contractual obligation of the parties, but to undertake actions leading to changes in the contract and renegotiation of the price. Therefore, in commercial practice, the Act of God clauses need to be invoked more often than the hardship clauses.

**An arbitration clause** may appoint arbitration as the way disputes resulting from performance of the contract. These disputes may be heard by either common courts or arbitration tribunals. Due to the high costs of proceedings before common courts, complicated procedures and the number of instances involved, in trading practice the disputes are usually brought before arbitration courts. Compared to common courts' procedures, arbitration has numerous advantages: the disputes are heard by experts, which is not always the case in common courts, the case is resolved in a relatively short period of time and usually by one instance only. Additionally, the arbitration costs are lower compared to those of court cases, and legal substitution (counsel for the defence) is not required.



**A liquidated damage clause.** In international practice, it is widely accepted that the amount of the penalty should correspond to the amount of actual damage which the parties could reasonably foresee while drawing up the contract. In a case when liquidated damages are provided for in the contract, and in the absence of other provisions, the party injured cannot claim from the debtor a compensation exceeding the penalty restricted under the contract, even if the actual damages are higher. The liquidated damage, under certain circumstances, may be subject to moderation (if the main essential commitment has been performed for the most part or when the amount of penalty is excessive).

**A valorisation clause** consists in fixing the payment under the contract to the currency subject to relatively low exchange rate fluctuations. Such a clause protects the parties against exchange rate risk. We can name five forms of currency clause:

- **full** – when the exchange rate of the contract currency changes, the price or the invoice value changes proportionally on the day of payment;
- **rate of exchange based** – the contract value is compared with the exchange rate of another, 'strong' currency (e.g. USD) on the date of the contract conclusion; a ratio fixed in this way remains unchanged and constitutes the basis for further calculations, resulting from the exchange rates on the date of payment;
- **currency basket based** – the currency of the contract is compared with the currency basket formed by the currencies chosen by the parties;
- **automatic price adjustment** in (full or in a certain) proportion of the fluctuations in the exchange rate of the contract currency to the domestic one – the clause comes into operation when the exchange rate fluctuations of the payment currency exceed the agreed percentage index e.g.  $\pm 4\%$ ;
- the **price revision** clause contains the provision that, in the case of a specified depreciation of the contract currency against strong currencies (e.g. over 5%), the exporter reserves the right to change the export price, i.e. a renegotiation of the price may take place.

**A complaint clause** – specifies 1) the times and modes for making complaints relating to both quantity and quality (e.g. a restriction that a claim should be submitted in writing); 2) the methods of documenting the claims so that the possibility to obtain additional benefits at the expense of the partner is excluded; 3) legitimacy of the claim and covering of the costs related thereof; 4) the way of dealing with the claim (repair, price reduction, etc.); 5) the way of preserving defective or faulty goods for evidence; 6) other necessary actions to be undertaken under the procedure, according to the nature of the claim or the specificity of the goods. Failure to submit a claim in the time specified deprives the claimant of the ability to claim damages under arbitration procedures.

It is advisable to incorporate into the contract other clauses adequate to the specificity of the transactions in certain goods or relating to the market situation. These can be:

- **a warranty clause**, which specifies the details of the warranty granted by the seller to the importer and to final buyers;
- **a clause defining the conditions of the receipt of goods**, i.e. required certificates, or the results of test or checks which must be performed prior to the receipt of goods;
- **a clause on the integrity of the trademark**, brand or design.

### 4.3. Settlement of international business transactions

Payments in international trade may be divided into two basic categories:

1. **Unconditional** – the beneficiary does not have to fulfil any additional conditions to receive the payment for the goods or services rendered (payment order, cheque, draft).
2. **Conditional** – to receive the payment, the beneficiary needs to fulfil specified conditions, most often by submitting appropriate documents representing the merchandise and relating to the obligations put on the buyer (documentary encashment and documentary letter of credit).

A **payment order** constitutes the least costly, fastest and easiest form of settlement in international trade. It consists in an instruction to make a payment received from or addressed to a bank, referring to the disbursement of a given sum for the benefit of the designated beneficiary.

A **cheque** is a document issued on a special form, bearing the unconditional order for disbursement by the bank – from the issuer's account – of the sum specified to the bearer of the cheque or the person named on the cheque. The issuer of the cheque is called the 'drawer', the bank is the 'drawee' and the person receiving payment is referred to as 'payee'.

In international transaction, banker's cheques are in use most often, made out by one bank to another bank or to a natural or legal person. It opens the possibility of receiving the payment directly after its submission to the bank.

A **draft**, like a cheque, is a security with the form specified by the bill of exchange laws. There are two kinds of drafts:

- a Bill of Exchange (drawn), also called a draft, issued by the exporter, who orders the buyer or his bank to pay the specified amount;
- a Promissory note, made by the importer in exchange for the goods received.

In **documentary collection**, the importer undertakes to settle the payment for the goods in exchange for the documents representing them. The exporter sends the documents, together with the collection instruction, directly or (more often) via his/her bank (intermediary bank) to the importer's bank (collecting bank), which in turn summons the importer to buy out the documents. Documentary collection does not offer sufficient certainty to the exporter, because the importer may refuse to buy out the documents submitted by the encashing bank.

A **letter of credit** (L/C) – the document by which the bank opening the credit authorises another bank to pay a determined sum to the payee named in the L/C and at the time fixed in the document. Under the L/C, the intermediary bank (the exporter's bank) is not involved at all: the opening bank sends the letter of credit directly to the beneficiary. The content of the letter authorises the beneficiary to make drafts drawn by him/her.

A **documentary credit** (D/C) constitutes an obligation of the bank, undertaken on the order of the importer, to pay to the beneficiary a fixed amount in exchange for the submission of documents – within the time specified – indicated in the credit document. The trade contract specifies the types of documents that the exporter will have to submit under the agreed credit arrangement. They are later reproduced by the importer in the order for the opening of the credit addressed to the bank and in the contents of the bank documents related to the credit opened. Banks usually provide standard forms to be filled in by the importer. Depending on the role of the opening bank (the importer's bank), letters of credit can be divided into revocable and irrevocable. In the case of **revocable credit**, the conditions may be altered without notifying the exporter. From the point of view of the risk it carries, this type of credit arrangement is close to encashment. **Irrevocable credit** cannot be cancelled or any of its conditions altered without prior approval by all parties involved. This type of credit fully secures the interests of the beneficiary.

From the point of view of the intermediary bank (the exporter's bank), (letters of) credit arrangements can be divided into confirmed, unconfirmed, advised and in the form of a letter of credit. In the case of a **confirmed credit** arrangement, the intermediary bank undertakes an identical commitment to the beneficiary (exporter) as the opening bank and takes on the obligation to pay the fixed amount to the exporter. The confirmation takes place on the order of the opening bank, while the intermediary bank has the right to refuse confirmation.

An **unconfirmed credit** arrangement can be of the nature of either an advised credit or a negotiation credit. In a negotiation credit, the intermediary bank has the right to negotiate the documents submitted by the beneficiary, that is, to check their compliance with the credit conditions. In the case of an **advised credit** arrangement, the role of the intermediary bank is limited to notifying the exporter about the opening of the credit, the subsequent forwarding of its contents and later to the receipt of the documents and their transferral to the opening bank.

In the case of a **transferable credit** arrangement, the beneficiary (exporter) has the right to order his/her bank (authorised to make the payment or negotiating the documents) to make a one-time transfer of the credit value, in full or in part, to the benefit of a third party. The partner opening the credit must give his/her permission for the credit to be transferrable. A **revolving documentary credit** constitutes the type in which the total amount, covering the value of the entire contract (the

limit or ceiling), is fixed. This amount can be used by the beneficiary in parts, with each part covering the value of a single delivery, thus gradually reducing the total credit value.

The arrangement providing for **back-to-back D/C** authorises the intermediary bank to open – against one D/C – another one for the benefit of another beneficiary, so that the transfers from the original one would cover withdrawals from the second.

When formulating a contract, one should pay particular attention to the following and check if the contract: includes a detailed description of the goods, price and terms of delivery; specifies the procedures for dispute resolution and the law governing the contract; provides the reasons for withdrawal from the entire contract or from part; gives the time of delivery; contains precise payment terms and guarantees. Frequent formal mistakes in international contracts are as follows: the contract is signed by a partner's representative without proper plenipotentiary powers; the stamp bears invalid data; the absence of dates, official names of the parties and clear ending with the parties' signatures; the absence of definitions for terms whose meaning may cause doubts; the use of terms which meaning may be different in various languages; the quality or condition of goods is not sufficiently specified; the absence of permitted tolerances regarding the weight, volume or other quantitative or qualitative features which can be subject to change during the fulfilment of the contract; the absence of penalties for late payments; the absence of payment guarantees; unclear provisions as to the time and place of the transfer of the ownership and the risk to the recipient; the choice of the third country law as the law governing the contract, which can result in high legal costs; the choice of arbitration court in the arbitration clause whose impartiality is doubtful; the lack of a *force majeure* clause and other clear reasons for the exclusion of parties' responsibility in exceptional situations; the absence of a revaluation clause in the situation of considerable exchange rate fluctuations; the adoption of unrealistic or risky dates of delivery; the absence or unclear formulation of clauses relating to the rules of inspection and the receipt of goods; inaccurate description of the subject of the contract, without type, brand, kind, size or quality.

## Questions and assignments

1. Explain which of the settlement forms in international trade is most advantageous for the exporter and which for the importer.

2. Where risks and costs are transferred from the seller to the buyer in a contract based on CIF?
3. What law governs a contract concluded between an EU exporter and an Argentinian importer?
4. How it is possible to diminish or eliminate exchange rate risk in international transactions?
5. What are the benefits for the parties resulting from the introduction of the *force majeure* clause into a contract?
6. Explain the reasons for forming strategic alliances in international trade.
7. Describe types of intermediaries and their roles in international trade.
8. Describe offset transactions and their advantages for the parties involved.
9. Describe the international commercial transactions which allow the problems resulting from the absence of convertible currencies to be minimised.

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# Chapter 5

## Insurance in international business transactions

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Insurance is a form of risk transfer onto another economic entity (an insurance company), in return for an appropriate price (an insurance premium). Such a solution is of particular importance in international business, because it allows businesses to calculate in detail the profitability of the planned transactions (including their costs) with the use of the fixed costs of insurance (the insurance premium) instead of calculating financial consequences of various risks, which are usually difficult to assess. By concluding the insurance contract and paying the insurance premium, the insured entity is relieved of the risk. Should the risk occur, the insured party will receive the financial means to cover the loss.

The risk is when the decision maker cannot predict with certainty future events that are known and can be determined statistically, so the risk is called the statistical probability of random negative events for the affected entity or defined situations in which the probability of at least one of the elements occurring is known. The effects of such a decision for the company will be adverse. The risk is measurable, can be estimated. It is common and it differs from uncertainty, which is incalculable, because there is a lack of statistical parameters for estimating a random event, and it occurs when decision makers know that all events are possible, but they do not know the probability of the elements involved. It is not possible to determine the probability of a random individual events that are unusual.

### 5.1. Classification of risks and risk management

International business transactions usually involve a greater risk than business activities run by companies solely on domestic markets. This is mainly because of the differences in economic, political, social, legal



or cultural systems, but it may also result from quite a large geographical distance between the home and host countries. The risk consisting of the possibility of the occurrence of events that are independent of the economic entities involved, and which cannot be foreseen or prevented, is usually related to assets. In this case, it mainly concerns goods, subject to export-import transactions and the processes relating to their movement (transportation, storage, presentation), although the risk may also be associated with the rendering of services or with capital flow. Thus, the risk-charged assets include the goods themselves, means of transport, unexpected additional costs or necessary financial inputs related to the storage of goods, their transportation and inspection.

Different types of risk associated with running an international business originate from various sources and can be classified according to a number of different criteria.

Risk management, aimed at reducing the possibility of risk occurrence and at alleviating its consequences, usually involves: risk identification, estimation and steering as well as, supervision of undertaken measures. Risk identification is meant to enumerate the types of risk that may occur in relation to international business activities.

Country risk is associated with the basic infrastructure essential for the company's operations: transport, telecommunications or the laws in force, but also with the economic situation (GDP growth rate, inflation, unemployment or debt). Other factors related to country risk may involve: crime, corruption, internal conflicts, civil unrest, strikes or terrorism in the host country. All these exert a strong influence on the security, efficiency and profitability of the business activities run. Therefore, managers need to take into account all possible consequences of political decisions taken in the host country, and to make appropriate political risk analysis prior to the commencement of their activities abroad.

Political risk involved in international business transactions concerns the type of, and general stability of, the socio-economic, political and legal systems in the host country. The increase of trade protectionism (including embargos) after the conclusion of a contract, introduction of payment restrictions, fluctuations of currency exchange rates or nationalisation may all lead to lower profitability, delays, freezing and termination of already concluded transactions, or even to the partial or total loss of property (resulting from confiscation or damage).

Technology risk, particularly likely to occur in the e-business era of today, is linked to the lack of security of electronic transactions, disturbances

in electronic data processing, absence of appropriate IT infrastructures, as well as the costs of rapidly developing technologies that, at the same time, are subject to unexpected failures or major breakdowns. All these may cause serious problems affecting the business activities undertaken in the host country.

Environmental risks, such as air, water or soil pollution (due to the company's activities) may – under the pretext of breaching the laws or executive and ecological regulations – lead to protests of neighbours, ecological organisations or other groups, thus freezing the planned investment or exploitation of the company's facilities. Consequently, this may result in hindering the business activities completely, even to the point of premature closure which, in turn, leads to the loss in assets and the company's reputation.

Economic and financial risk is linked to the developments in fiscal and monetary policy, interest and currency exchange rates fluctuations, but also to the inflation rate, GDP, unemployment, financial liquidity of the host country (capability of settling foreign liabilities) or with the freedom to transfer profits. International transactions and investments undertaken by a company may be affected intensely by fluctuating exchange rates, which may exert a negative impact on the value of income transferred to the home country at a time of currency depreciation in the host country.

The risk subject and source are often used as criteria for risk categorisation. According to the risk subject criterion, we can distinguish two basic types: commodity risk – related to the state of the goods, and commercial risk, which, in turn, may be divided into: market risk, related to difficulties in sales due to adverse conditions on the recipient market, and transaction risk, directly related to the concluded contract. The principal risks, which may occur due to the ill will of the contractor, include: a breach of the contract, delay, refusal to deliver or receive the merchandise, or deliberate provision of a smaller quantity or lower quality goods than agreed under the contract. Contractual obligations may also be infringed by falsifying the documents relating to the commodities traded, delays in and a partial or total refusal of payments due. A failure to meet contractual obligations may, however, result from objective reasons, such as an act of God – extraordinary forces of nature: earthquakes, hurricanes, fog, sea storms, volcanic eruption, lightning, avalanche. Exercise of powers by the authorities, such as – previously mentioned – the imposition of trade restrictions, confiscations or changes in the exchange

rate can also affect execution of the contract. Finally, the reasons for non-performance of contract may result from human activity: warfare, revolutions, industrial actions, riots or terrorist acts.

Specific types of transaction risks may be associated to particular categories of contracts. In re-export transactions, for example, the risk may consist in limitation, or the denial, to claim damages, if the commodities have been transferred to a destination other than the country of destination precisely set in the re-export clause. Switch transactions bear the inherent exchange rate risk, since their essence lies exactly in the exploitation of exchange rates and price differences. In the case of tied and compensation transactions, whose essence lies in one contract's execution being dependant on another, substantial differences in times and values of mutual deliveries may occur (although, as a rule, this generally should not take place under these type of contracts). In the most extreme cases, a contractor may fail to fulfil his/her obligations, despite proper execution of the contractual commitments by the other party. Some kind of agreements accompanying the main (trade) contract may also cause exposure to risk, e.g. agency, commission or consignment risk.

Price risk concerns the likelihood of movements in commodities prices that may occur – to the detriment of one of the parties – between the conclusion of the contract and its settlement. Exchange rate risk or currency risk is involved in the case of exchange rate fluctuations (appreciation/revaluation or depreciation/devaluation). Efficient management of this risk is very often of key importance for a company's survival on the market. Commodity theft risk has always been associated with all types of commercial transactions.

Risk related to the choice of distributions channels may take the form of an intermediary illegally transferring information and data to competitors or presenting the goods inappropriately, thus leading to lower sales. Commodity risk is associated with the possibility of loss or damage of goods, change in their numbers, shape or quality, or with the necessity to incur additional costs to prevent (or reduce) these losses at every stage of the goods transfer.

Transport risk is quite specific in relation to foreign trade. This is because the goods are often moved over long distances and therefore the cost of transport and the associated transfer of the risk from the seller to the buyer constitutes a vital part of the contract price. The costs of transport depend not only on the distance but also on the modes of transport employed (by air, rail, road, sea or by inland waters). The moment of

transfer of risk and the mode of transport are agreed under the contract within the terms of delivery. This can be done either indirectly – by use of one of the Incoterms, applicable only to water transport (FAS, FOB, CFR, CIF) or directly, in the mode of transport clause. Thus, the seller loses the freedom to choose the mode of transport, which is not the case when CPT, CIP, DAT, DAP and DDP are used. It is of vital importance for the buyer under the CPT and CIP formulas, since the risk is transferred to him/her before consignment starts (at the moment of loading into the means of transport), while the seller – enjoying the freedom of choice – could choose the least expensive means of transport, usually incurring the highest risk.

Damage to the goods or their loss may be caused by various factors. In all branches of transport this may result from improper loading, unloading, packaging, stowage, accident of the means of transport, uncontrolled movement of the load within the means of transport, fire, or theft. Some kinds of goods are more prone to damage, due to their natural features, e.g. dangerous goods (explosives, chemicals), perishable goods (fresh vegetables, fruit, flowers, meat, natural leather) or fragile items (glass, ceramics, eggs) and therefore, if not properly secured, are more exposed to damage in the case of transport accident.

Additionally, in the case of sea transport, the damage can be caused by constant movements (due to swinging), soaking with water, sinking of the vessel, stranding, piracy (near Indonesia, Bangladesh, Nigeria, Somalia), theft or ransom demands. Other possible causes of damage or loss include: collision, containers falling overboard (due to improper fixing), bankruptcy of the ship-owner, closure of the port, storm and unfavourable weather conditions delaying loading or unloading. A General Average act may occur, when the captain intentionally decides to sacrifice part of the cargo or to incur extraordinary costs in order to save the whole load in the case of an emergency. Part of the cargo can be thrown overboard to save the crew, the vessel or the rest of the cargo, when, for example, the loosened containers become dangerous. Under the General Average rules, the loss or the costs are shared proportionally by all parties with a financial interest in the voyage. The General Average claims are settled by average adjusters or dispatchers, according to the rules codified in the York-Antwerp Rules.

The damage or loss risk factors in air transport, usually lower than those in sea freight, are usually associated with the changes in pressure during the flight, differences in temperature or dampening of goods on the airport apron. Risks in road transport, more frequent than under other

modes, are usually associated with road accidents or soaking of goods during carriage, loading or unloading. Loss or damage to the goods, resulting from negligence, mistake or failure to act by the party involved in a given phase of transaction, are not recognised as risk-driven.

From a quantitative point of view, damage claims may be divided into partial damage, whereby only part of the indemnified assets are damaged, and two types of total loss. Actual total loss occurs when the commodity is no longer the same, having lost its properties and function, while the owner is deprived fully of his/her assets. In the case of constructive total loss, the commodities are not entirely lost and can be recovered, however, at a cost disproportionate to the value of the goods. The notion of constructive total loss is closely linked to the abandonment instrument, that is yielding the property rights to the benefit of the insurer in return for the payment of the total insurable value to the insured.

## **5.2. Liability of carriers in international transport**

As a general rule, the carrier is liable for all risks related to loss or damage to the goods from the moment of taking over the commodities until their delivery to the recipient. The fault of the carrier is presumptive, i.e. it is assumed that the carrier has not exercised due diligence. The damages for lost or damaged goods may be claimed from the carrier or the insurance company by the owner, provided that the commodities have been indemnified. The responsibilities of carriers for loss in international transport are, however, limited by the provisions of the relevant international conventions.

### **5.2.1 Liability of carriers in maritime transport**

In accordance with the Hague-Visby Rules, the liability of the carrier is limited both to the scope and the total value of damages due, and calculated as 666.67 SDR (Special Drawing Rights) multiplied by number of packaging units, or 2 SDR per kilo of gross weight (whichever one is the higher). The carrier is not responsible for damage caused by: a) an act of neglect or default of the captain, crew members, pilot, or the employees of the carrier in the navigation or in the management of the ship, b) perils, dangers and accidents of the sea or other navigable waters, c) fire, unless caused by the actual fault of the carrier, d) wars, acts against public order, riots, strikes or lockouts, or other conditions hampering

the carrier's operations partially or generally, e) attempts to save life or property at sea, f) latent defects of the vessel, not discoverable by due diligence, g) any other cause arising without the actual fault of the carrier, his agents or employees.

### **5.2.2 Liability of carriers in road transport**

Under the CMR (Convention on the Contract for the International Carriage of Goods by Road), the carrier is relieved of responsibility if loss, damage or delay has been caused by: a) wrongful act or neglect of the claimant or instructions given by him/her without any fault on the side of the carrier, b) inherent defects of the goods or circumstances which the carrier could not avoid and the consequence of which could not be prevented, c) use of open, unsheeted vehicles, when their use has been expressly agreed and specified in the consignment note, d) the lack of, or defective condition of packing in the case of goods which, by their nature, are liable to wastage or to be damaged when not packed or when not properly packed, e) handling, loading, stowage or unloading of the goods by the sender, the consignee or person acting on behalf of the sender or the consignee, f) the nature of certain kinds of goods which particularly exposes them to total or partial loss or to damage, especially through breakage, rust, decay, desiccation, leakage, normal wastage, or the action of moth or vermin, g) insufficiency or inadequacy of marking, h) carriage of livestock.

The amount of damages due (with the exception of the case when the consignment note contains a declaration of the value of the goods and the amount representing special interest in delivery, relating to loss, damage or delay) cannot exceed 8.33 SDR per kilo of missing gross weight and the total value of the shipment at the place and time of acceptance for carriage. Additionally, the carrier is obliged to return the carrying charges (or refrain from claiming them) as well as to refund the customs duties and other charges related to the shipment in full or in proportion to the loss incurred. These obligations are also of compensatory nature.

### **5.2.3. Liability of carriers in rail transport**

Compensation for the damage to a consignment is set as an equivalent of percentage loss in value, although it may not exceed the amount of compensation which would be payable in the case of the loss of

the entire load, calculated according to the stock exchange value, or in its absence, according to the market price. If the market price cannot be established, the reference price is that of the usual value of the goods of the same kind or type on the day and at the place where the load was taken over by the carrier. In accordance with the CIM Rules (Uniform Rules Concerning the Contract of International Carriage of Goods by Rail), the compensation should not exceed 17 SDR per kilogramme of gross mass short. Apart from the compensation, the carrier must refund the carriage charge, customs duties paid and other sums paid in relation to the carriage of the lost goods, with the exception of excise duties on goods carried under a procedure suspending these duties. In respect to goods which are subject to wastage by reason of their nature, the carrier, regardless of the length of the route, is only liable to the extent to which wastage exceeds the following allowances: a) 2% of the mass for liquid goods or goods consigned in a moist condition, b) 1% for the mass of dry goods. Such limitation of liability cannot be invoked if the loss was not due to causes which would justify the allowance when the loss has been caused deliberately or by obvious negligence, recklessness or omission of the carrier, from whom the authorised person may claim damages in the full amount, covering both the loss related to the goods and the lost benefits that the party could gain, provided that the goods have not been lost.

#### **5.2.4. Liability of carriers in air transport**

The carrier is not liable to the sender, recipient or other parties, if the destruction, loss or damage to cargo results from an inherent defect, quality or type of the cargo, or if the loss, delay or destruction was not due to negligence or omission by the carrier and when the damage or loss was caused by the negligence or omission by the sender, recipient or another claimant party. The carrier's liability, in accordance with the Warsaw and the Montreal Conventions, is limited to 17 SDR per kilogramme of the gross mass of the cargo lost, damaged or delayed. If the sender has submitted a declaration of the cargo value, and paid additional charges related thereto, the carrier's liability is limited to the amount declared in the Air Waybill.

Summing up, the carrier's liability covers exclusively the damage caused by the carrier's fault, but cannot exceed the limits laid down by international conventions. The carrier's responsibility does not cover



the loss or damage occurring due to circumstances the carrier could not avoid. When the value of goods exceeds the liability limits specified by relevant conventions, the liability for the loss, damage or wastage exceeding the limits falls on the sender/recipient.

### **5.3. Methods for mitigation of risk**

Risk assessment, conducted with the use of various criteria, enables identification of the risk factors to which particular attention should be paid. In turn, steering means undertaking preventive measures aimed at protection against the risk or – at least – at bringing it down to acceptable levels. One can actively exert influence on the sources of particular risks or concentrate passively on protecting oneself against potential loss.

There are active and passive techniques of risk mitigation in international business.

Exerting active influence may consist in: a) avoiding, which is turning down contracts exposed to excessive risk, b) undertaking preventive measures precluding the occurrence of random events, c) transfer of risk and responsibility for covering potential damages onto other entities by: insurance, warranties, guarantees or forward contracts, d) concluding hedging (protective) transactions, to protect oneself against disadvantageous price developments in the future. A hedging transaction is concluded in parallel with a real futures contract (e.g. future purchase) as a reverse transaction (future sell). A selling hedge is used for the purpose of insuring against a possible decrease in commodity prices, while a buying hedge protects against price increase, e) diversification, leading to alleviation of the risk level by concluding transactions and running the business in various countries, with different partners and in several branches. A passive approach to risk steering consists in setting up the appropriate financial reserves to cover potential future losses.

The main objective of risk supervision is to assess the efficiency of undertaken risk mitigating measures and drawing conclusions as to the necessity to take adequate decisions and actions.

### **5.4. Types of insurance contracts**

An insurance policy – a basic type of standard insurance document which confirms the conclusion of an insurance contract. It contains a number of essential clauses, such as the name of the insurer and



insurant/insured (or assured), the quantity, quality and type of property insured, the scope of the insurer's liability, the policy period, type of risks covered, the policy limits (amount/value of insurance), the modes for documenting and submitting claims, the modes and means of transport, signature of the insurance company's representative. There are several types of insurance policies:

**A single policy** – confirming the conclusion of an insurance contract covering a specific subject during the period fixed in the policy. The liability of the insurer expires at the time stipulated in the policy or when the shipment has been delivered to its final destination. This type of policy is less and less popular and serves mostly the purpose of indemnifying single shipments, while general framework policies are by far the more popular. In the latter case, one insurance contract covers all or selected types of goods that the insured has sent or received within the period fixed under the contract. The general policy confirms the conclusion of the insurance contract, under which the insured undertakes to indemnify all shipments covered by the contract and the insurer takes on an obligation to accept all these shipments for insurance. We can distinguish between the general floating policies and general block policies. Under a floating policy regime, the insured submits to the insurer the specification of export and import consignments/cargos at fixed times. Their value is deduced from the face amount of the policy. This procedure is repeated until the insured sum is exhausted and the new contract is concluded. In the case of a block policy, the insurance covers under uniform conditions the entire course of trade and not single shipments. The parties agree as to the total volume of transactions under the entire course of trade and the insurance premium is calculated proportionally to that volume and paid in instalments specified in the contract. This type of policy is used when the goods traded by the insured are rather homogenous in nature and the shipments are exposed to similar risks of damage or loss. The insurer is often obliged to issue insurance certificates for individual shipments, in particular when the trade contract obliges the exporter to submit such a document to the importer (in the case of contracts concluded under CIF or CIP formulas). An insurance policy is a valuable document and can be transferred by giving, endorsement and assignment of rights.

**A certificate of insurance** is a document issued under the general policy and verifies the existence of coverage under an insurance policy

contract. The document stipulates that the person indicated (insurant) has concluded a general policy, under which the subject named in the certificate has been covered. The certificate also contains the clause confirming that, in the case of loss or damage, the certificate holder is entitled to receive compensation. The insurer usually designates the body which should be informed about the damage done and provides an instruction detailing the procedures related to the calculation of the compensation due, securing recourse rights and listing the documents required for dealing with the claims. The certificate of insurance is usually issued when there is no time to issue the general policy or when the certificate is used as a confirmation of conclusion of the insurance contract by the seller for the benefit of the buyer. It is transferable (to the buyer) via indorsement or giro, but can be also issued on request

**A cover note** – is one of the documents confirming the conclusion of an insurance contract and issued temporarily by the insurer, by which the insurer guarantees the insurance cover until the moment when the full policy is issued, until a framework insurance contract is concluded or finally negotiated and only minor provisions are being discussed. The note includes the key elements of the insurance contract, that is: the names of the insured and the insurer, the date of issue and expiry of the note, the subject and scope of insurance (types of risks covered) and provides the same level of risk coverage as the full insurance policy, sometimes with some restrictions only. The insurers may grant the holder of the cover note the right to withdraw the policy within a fixed period and to receive a refund of the premium paid, on condition that during this period no claim for damages has been made. A cover note is sometimes issued within the framework of a general insurance policy to confirm that for a particular subject-matter of insurance the parties agreed to apply specific conditions, different from the ones provided for in the general policy. Some insurance companies issue certificates of insurance instead of cover notes.

**A broker's slip** is prepared by a broker, who participates in the preparation of an insurance contract or facilitates its conclusion, and who also takes part in its management and execution – in the name of, and on behalf of, a subject intending to conclude a policy. The slip, containing the key elements of the future policy (the names of the insured and the insurer, subject and types of risk, insurance amount and the rate of insurance premium) is submitted to the insurer whose signature on

the documents equals his/her acceptance to take over the risk. Within a specified time – until the policy is issued – the parties may resign from the conclusion of the contract.

The subjects of insurance contracts in maritime transport may be every financial interest related to sea transport that can be expressed in *monetary terms, such as the vessel and the cargo with the expected profit on it, freight, charter fees, commissions, general average expenditure or fees for passengers' carriage*. Contracts can be concluded in respect to a particular voyage, for a fixed time, as well as for the time and the voyage (*mixed contracts*). The parties to the contract are the insurer and the insurant (not the insured), to whom the policy is presented and who pays the insurance premium. The insurant can conclude the contract with the insurer in three forms: for his/her own account, to the benefit of a third party (the insured) and to the benefit of the person concerned, in the case when the insured is not named in the contract. Thus, a third party, who is not party to the contract, may still be entitled to compensation.

The right to compensation depends on the existence of the financial interest on the side of the party submitting a claim. Therefore, this may be the insurant, until the moment of risk transfer to another entity, the person named in the insurance contract, to whom the rights resulting from the contract have been transferred, or the person submitting the policy issued to the bearer or on request.

The sum insured cannot exceed the value of the subject of insurance and the compensation cannot be higher than the loss suffered. The settlement of the claim may take the form of payment of compensation, payment of the full amount insured without transfer of ownership rights to the insurer, or with such a transfer, that is, with abandonment. The application of abandonment procedure may accelerate the claims settlement under constructive total loss, in particular when: the vessel is missing without a trace, has been captured and it is not worth the price of its recovery, was involved in an accident and is not worth the price of the repair, or when the cost of cargo delivery would exceed its value. Abandonment is not compulsory and, even when declared by the insured, may sometimes not be accepted by the insurer.

The insurers often tend to transfer part of the loss or damage suffered onto the insurant by introducing a franchise, which is the minimum value of a loss, below which no payment is made. The limit of this minimum can be set as a fixed amount or as a percentage of the sum insured. If the loss exceeds the agreed minimum, then – in the case of

an integral franchise (conditional) – the total amount insured is paid. In turn, in the case of deductible franchise (unconditional), regardless of the actual value of the loss suffered, the insurer deducts this minimum amount (franchise) from the total amount of compensation. Thus, the insurer may exempt from liability some petty losses or damages not related to random events.

As mentioned, the franchise can be suggested in the form of a quota, for example 1000 EUR, or as a percentage of the sum insured, for instance 2% – for the sum insured in the amount of 1000000 EUR, the franchise will be 20000 EUR.

Example:

For the integral franchise of 20000 EUR, the insurer has no obligation to repair the damage worth 19900 EUR, but absolutely it will have to pay compensation in full for the damage 30000 EUR.

In the case of deductible franchise of 20000 EUR, similarly, the insurer has no obligation to repair the damage of 19900 EUR, but for the damage 30000 EUR pays compensation of 10000 EUR (30000–20000).

## 5.5. Policy insurance conditions

In practice, three sets of cargo clauses known as the **Institute Cargo Clauses** (ICC) are used when concluding the insurance contracts. These are the A, B and C cargo clauses model insurance conditions, formulated by the Institute of London Underwriters. The clauses are of universal nature and can be applied to most types of cargo and means of transport. Originally, the clauses used to be applied to maritime carriage and, therefore, for rail and road shipments, the clauses are used with the exclusion of those provisions which are not applicable to these modes of transport. The scope of insurance coverage depends on the agreed set of clauses. The widest scope, based on the 'all risk' rule, is offered by the ICC (A), while the B and C sets offer coverage limited only to the named types of risk. On 01.02.2009, the Institute of London Underwriters published the Institute Cargo Clauses (A), (B) and (C), the Institute War Clauses (Cargo) and the Institute Strikes Clauses (Cargo) Each set contains 10 clauses which differ as to the risk clause – provided for under number 1.

**In the A set of Clauses** – insurance covers the risk of loss or damage with the exception of those resulting from: wilful misconduct, normal wear, insufficient or unsuitable packing, unseaworthiness of the vessel, wars, strikes or lockouts.

**Under the B Clauses** – the insurance covers loss or damage due to: fire or explosion, stranding, the sinking or capsizing of a vessel, the overturning or derailment of land vehicle, collision or contact of a vessel, craft or vehicle with any external object, the discharge of cargo at a port of distress, earthquake, volcanic eruption, lightning, general average sacrifice, jettison or washing overboard of the subject-matter, entry of water into the vessel, vehicle or container or place of storage and total loss of cargo during loading or unloading.

**The C Clauses** provide for coverage of loss or damage caused by: fire or explosion, stranding, the sinking or capsizing of a vessel, the overturning or derailment of land vehicle, collision or contact of a vessel, craft or vehicle with any external object, discharge of cargo at a port of distress, earthquake volcanic eruption, lightning, general average sacrifice, jettison or washing overboard, etc. Under the **Institute Strike Clauses** (Cargo) of 1.1.09, the insurance covers the loss or damage related to the subject-matter insured caused by: strikers, locked-out workmen, or persons taking part in labour disturbances and riots or civil commotions; acts of terrorism or deeds by persons acting on political, ideological or religious motives. The insurance also covers: general average and salvage costs, settled or agreed in accordance with the freight contract and/or the law and practice applicable, incurred in order to avoid or in relation to attempt at avoidance of the loss or damage covered under the clauses in question. The **Institute War Clauses** (Cargo) of 1.1.09 provide for coverage of the loss or damage to the subject-matter insured due to: a) war, civil war, revolution, rebellion, insurrection or civil strife arising therefrom, or any hostile act by or against a belligerent power, b) capture, seizure, arrest restraint, or detainment, arising from risks covered under point a), c) derelict mines, torpedoes, bombs or other derelict weapons of war. The insurance also covers general average and salvage costs settled or agreed in accordance with the freight contract and/or the law and practice applicable, incurred in order to avoid, or in relation to attempt at avoidance of, the loss or damage covered under the clauses in question. Apart from the foregoing clauses, a number of additional clauses are applied, such as: the general average clause, the both-to-blame collision clause, which provides that the liability of the insurer (underwriter) covers the period from the release of the cargo from a warehouse until the time of delivery of the cargo to a warehouse (until the expiry of a 60-day period after unloading).

The Change of Voyage clause provides that in the case of changed destination, the insurance contract is valid in return for an additional premium

and on condition of immediate notification of the change to the insurer. The Forwarding Charges clause concerns the situation where the transit of cargo terminates at another port than the originally agreed port of destination. The insurer returns the costs of unloading, warehousing and forwarding the subject-matter to the destination to which it is originally insured. The clause exempting the transfer of insurance rights (benefit of insurance clause) protects the insurers against a situation in which the carrier makes a reservation in the contract of carriage that he/she will not be liable for the loss or damage covered by the insurance. The Duty of Assured clause puts on the insured an obligation to undertake all possible measures in order to avert or minimise the loss, while any costs or charges related to the fulfilment of these duties will be returned by the insurer. The Avoidance of Delay clause requires the insured to undertake prompt action in the case of an emergency, to avoid or minimise the loss or damage.

Insurance of containers and the goods carried in containers includes specific types of losses or damage related to improper loading and stowage of goods in a container, placing different goods in one container, improper handling of the container or a prolonged absence of inspection of the state of the goods.

Insurance of exhibits presented at fairs and exhibitions – usually concluded in the form of a package including: a) insurance of exhibits in transport (covering all kinds of exhibits and exhibit booths and equipment transferred by various means of transport, b) insurance during the exposition and storage, covering such risks as fire, theft, robbery and other random events, c) insurance of civil liability arising out of use of the display space. The insurance covers the loss or damage related to the assembly, dismantling and display of exhibits. Financial compensation is due in the case of bodily harm, health disorders or death of a third party, or for the loss or damage to the possessions belonging to third parties. Additionally, it includes the costs of legal protection in the case of a lawsuit brought against the exhibitor.

The credit insurance secures the covering of financial losses of debtors that may occur in the case of non-repayment of the loans.

## 5.6. Procedures for settlement of claims

A typical procedure for the insurance claims, in the event of loss or damage, starts with: 1) immediate notification addressed to the insurer or – when it is not possible – to the average agent named in the policy

or the certificate of insurance; alternatively, if such a certificate has not been issued or no agent has been designated, an average agent accredited by the insurer should be employed in order to organize the investigation aiming at the determination of the circumstances, cause, kind and scope of loss or damage to goods; 2) if it is not possible to appoint an average agent accredited by the insurer, or he cannot come within 24 hours, an independent agent should be appointed; 3) the insured and their subordinates or representatives are obliged to undertake any necessary steps to minimise the loss or prevent further damage; 4) the insured is also responsible for securing all rights against the carrier or forwarder who were dealing with the cargo. In particular, the insured, their subordinates or their representatives should: a) submit a written claim to the carrier or any other entity responsible for loss or damage; b) submit a written order for the investigation of the cargo by the carrier's representative or other party if the loss or damage is apparent c) immediately notify the police if it is suspected that the loss, destruction or damage to the insured property has resulted from negligence or a wilful act aimed at inflicting damage, or if other attributes of criminal acts are observed; d) in the case of objections concerning the condition of goods, a written complaint should be lodged immediately; e) if the loss or damage to the cargo was not apparent during the delivery, the carrier or other responsible entity should be informed within a few days of the receipt of the goods. The insurer may reject to pay a claim in full or in part if the insured party does not fulfil the above mentioned requirements which results in: a) the increase of the insurer's liability for loss or damage; b) making it difficult to determine the circumstances, the cause and the scope of damage and c) making it not possible to secure recourse rights against carriers or other entities responsible for the damage or loss.

In order to launch the procedure of the claim, the insured should send the insurer or the average agent the following documents: a) the original copy of the policy/certificate or reference data of the policy and number of registration for insurance, b) a document confirming shipment, such as a consignment note (in original), CMR, AWB, CIM or other transportation documents, c) a document confirming the delivery of goods (in the case when possible loss has been noticed, the document should bear the annotation relating to the missing or damaged goods), d) an invoice and specification (or packing list), e) a claim accompanied by the calculation of the loss, f) if possible, a report on the cause, nature and scope of



the loss or damage, drawn up to the order of the insured or the carrier (or any other entity responsible for the loss), g) documents attributing the loss or damage to carriers, port authorities or other bodies, h) any other documents concerning the claim and requested by the insurer.

### Questions and assignments

1. Name types of risk involved in international business transactions.
2. Discuss methods of currency risk mitigation in international business transactions.
3. What is *abandonment* and why it is used?
4. Name types of damage/loss in insurance.
5. List types of risk excluded from insurance in Set A of the Institute Cargo Clauses.
6. Name basic types of insurance documents.

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## Chapter 6

### Customs procedures in foreign trade

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All imported and exported goods must be customs cleared. This is applicable to the items brought in as personal ones and also imported by trade and business establishments. Customs policy that stipulates the conditions under which goods and are eligible to be exported, imported, processed, stored or undergo other customs approved use and customs procedures, is highly coordinated by member countries, especially those of the World Customs Organization (180 countries) and the World Trade Organization (162 countries), whose objectives are to secure the highest degree of harmony and uniformity in customs systems by developing and maintaining international customs instruments such as the Agreements on Customs Valuation and Origin, the Harmonized System Convention,<sup>1</sup> the Revised Kyoto Convention,<sup>2</sup> the Istanbul Convention<sup>3</sup> and other instruments developed by other multilateral institutions encouraging the uniform application of simplified and harmonized customs systems, procedures and the increased use of IT. This is why the European Union customs regulations described in this chapter do not differ from those of other countries.

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<sup>1</sup> Harmonized System Convention – entered into force in 1988. “HS” is a multipurpose international product nomenclature developed by the WCO through the Harmonized System Committee and used by more than 200 countries and economies as a basis for their customs tariffs and for the collection of international trade statistics.

<sup>2</sup> Revised Kyoto Convention (RKC) on the Simplification and Harmonization of Customs Procedures (the Kyoto Convention was adopted in 1973, revised in 1999 and entered into force in 2006).

<sup>3</sup> Convention on Temporary Admission/ATA/, Istanbul (1990) entered into force in 1993, merged 13 existing temporary admission agreements into a single instrument.

## 6.1. European Union Customs Code

The European Union forms a single customs area, whereby customs laws are uniformly applied. It is the result of the existence of the customs union, which eliminates borders between the Member States creating a single customs area, with a uniform customs tariff applied to goods originating from third countries. The system of EU customs law consists of directly applicable provisions of primary law (treaties), secondary law (regulations and decisions) as well as international agreements and customs regulations adopted by individual Member States. The most important document of the Union's customs law is the Union's Customs Code (UCC) which entered into force on 30<sup>th</sup> of October 2013<sup>4</sup>, although on its basis the former provisions are still being applied<sup>5</sup>. The substantive provisions of the UCC apply only from 1<sup>st</sup> May 2016.

## 6.2. TARIC – Integrated Tariff of the European Union

The integrated Tariff of the European Union – TARIC – contains the system of goods codes (customs nomenclature), all requirements (together with the legal bases and explanatory information) and measures of commercial policy, applied to particular goods imported and exported to/from the European Union. These include: ad valorem, specific and mixed tariff rates; customs preferences (including tariff quotas and tariff ceilings), the Generalised System of Preferences (GSP), applied to developing countries; countervailing duties, antidumping duties (temporary and definitive), suspension of duties, supplementary charges and countervailing charges, minimum and reference prices, quantitative limits (quotas), imports and export prohibitions, export refunds, export repayments, release into free circulation, conditional exportation, as well as data for the surveillance of imports and exports. TARIC does not include, however, information on national taxes (e.g. VAT and excise duties). The Directorate General for Taxation and Customs Union assigns the code numbers and publishes them daily on the official TARIC website.

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<sup>4</sup> Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code (Official Journal of the European Union L 269 of 10.10.2013). Commission Implementing Decision of 29 April 2014 establishing the Work Programme for the Union Customs Code (2014/255/EU) Official Journal of the European Union L 134/46 of 7.05.2014.

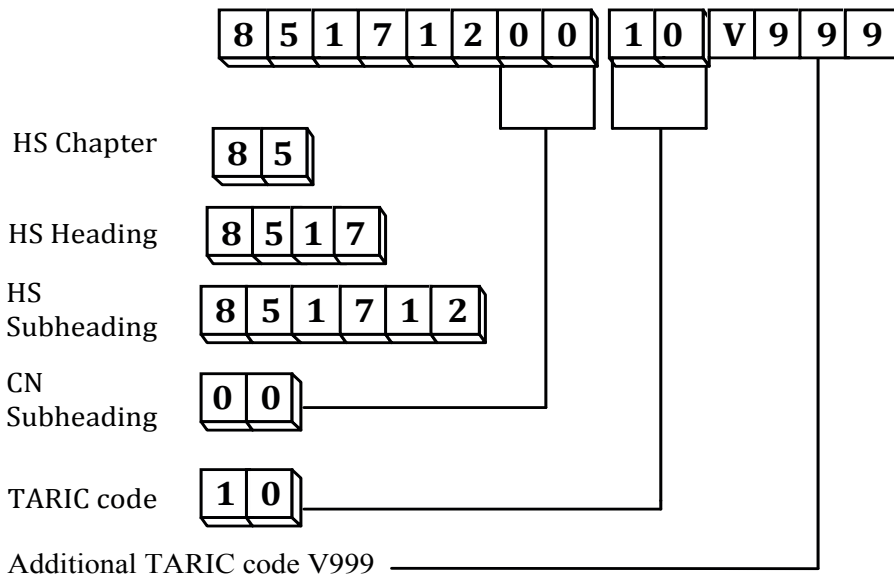
<sup>5</sup> Community Customs Code (CCC) established by the Council Regulation (EEC) No 2913/92 of 12 October 1992 and implementing provisions to CCC (established by Commission Regulation (EEC) No 2454/93 of 2 July 1993 with later amendments).

The tariff is based on the Combined Nomenclature (CN), introduced for the purpose of the Common Customs Tariff and for statistical purposes. CN is in turn based on the Harmonised System (HS) for labelling and coding of goods, established by the international convention and subsequently extended by Union's subdivisions, called CN subheadings added in the case where a duty rate is specified for them. Every CN subheading has an 8-digit code.

The first six digits are the code numbers referring to HS headings and subheadings, while the seventh and eight digits identify the CN subheading. The ninth and tenth digits are those relating to TARIC subheadings. In the absence of them, the ninth and tenth digits are '00'. The 10-digit TARIC codes can be further subdivided with the use of additional codes, when specific EU measures are applied but not coded, or not entirely coded, at the ninth and tenth digit level and it would be pointless to divide the very codes of the goods' nomenclature. Supplementary codes are used when the following measures are applied: combined anti-dumping and countervailing duties, agricultural components, reference prices for fish or in the case of CITES products (defined by the Washington Convention) or some pharmaceutical products. The supplementary codes consist of four alphanumeric characters (letters and/or digits). The first letter or digit of the code represents a separate nomenclature and has its own description. For example, the letter 'A' stands for anti-dumping. For their internal purposes, the EU Members States may insert subdivisions after the CN subheadings, and the TARIC subheadings and the identifying numeric codes are assigned to such subdivisions.

The 10-digits TARIC codes, and, where appropriate, the supplementary codes, are applied to all imports of goods from non-EU countries and from the new Member States during the transitional period. In the case of exports and intra-Community transactions, the 8-digit CN codes are applied and, where appropriate, the supplementary codes.

The example of classification for 'radio-telephonic apparatus for use in civil aircraft': Section XVI. Machinery and mechanical appliances; electrical equipment. Chapter 85. Recorders and reproducers of sound or image. HS heading 8517. Apparatus for the transmission or reception of voice, images or other data. HS subheading 851712. Telephones for cellular networks or for other wireless networks. CN subheading 00 indicates the absence of further subdivision. TARIC subheading 8517120010. Radio-telephonic apparatus for use in civil aircrafts. The country supplementary code V999 indicates that the VAT rate applies to this product (see Fig.6.1).



**Figure 6.1.** Structure of the TARIC code

Source: Own work based on TARIC

If a particular merchandise is classifiable under two or more headings, preference should be given to the heading providing the most specific description. When goods consist of different materials, or are made up of different components which cannot be classified, then the goods should be classified according to the heading classifying the material or component which gives these goods their essential character.

In case of doubts regarding the classification of a subject of a foreign trade transaction, an interested party may apply to the customs authorities for the official confirmation of classification for the goods in question, i.e. for a Binding Tariff Information (BTI), indicating the appropriate CN code. The BTI is valid in all EU Member States for six years from the date of delivery.

### 6.3. Documenting the origin of goods in foreign trade

Depending on their country of origin, imported goods are treated differently from the customs point of view. The application of a given duty rate depends on complying with the requirements laid down in

the rules of origin and on providing evidence that the given goods come from the country or from the territory for which a rate was set. The rules of origin identify the economic association of goods with a single country (area) that can be recognised as the place of origin.

The European Union's non-preferential and preferential rules of origin of goods, provided for in its customs code and implementing provisions, set the rules for determining the origin of the goods entering into and sent outside the Union's customs area.

The **rules for determining the non-preferential origin** of goods were laid down for the purpose of applying the tariff measures (Common Customs Tariff) and non-tariff measures established in EU provisions regulating individual sectors of trading.

Goods acquire the non-preferential origin of a given country or territory if: they are entirely obtained in a given country or if the last substantial processing has taken place in this country. The customs authorities may require that the declarant prove the origin of the goods in order to ensure that the origin indicated complies with the rules laid down by the relevant Union legislation.

The **rules of preferential origin** of goods are laid down in agreements on granting customs preferences concluded with some countries or adopted unilaterally by the European Union in order to apply preferential tariffs and non-tariff measures.

#### **6.4. Customs value of goods as a basis for determining the charges due**

There are several methods for determining the customs value of goods:

- the transaction value method (primary),
- the transaction value of identical goods method,
- the transaction value of similar goods method,
- the unit price method (deductive),
- the computed value method,
- the residual valuation provision method.

The following conditions must be fulfilled to determine the transaction value:

- a) there are no restrictions as to the disposal or use of the goods by the buyer; the sale or price is not subject to conditions or considerations for which a value cannot be determined,
- b) no part of the income from any subsequent resale, disposal or use of the goods by the buyer will accrue directly or indirectly to the seller,
- c) the buyer and seller are not related, or if they are related the transaction value can be accepted under certain conditions.

In order to determine the customs value with the use of the **transaction value method**, the price actually paid or payable for imported goods **must be supplemented by**:

- a) elements such as: commissions and brokerage fees (buying commissions excluded), costs of containers (if, for customs purposes, they are treated as being one with the merchandise), costs of packaging (both labour and materials) – to the extent that they were incurred by the buyer but not included in the price actually paid or payable for the merchandise,
- b) the apportioned value of the following goods and services, delivered directly or indirectly by the buyer free of charge or at a reduced price for use connected with the production and sales for export of the imported goods, to the extent that such value has not been included in the price actually paid or payable:
  - materials, components, parts and similar elements incorporated into the imported goods,
  - tools, dies, moulds or similar elements used in the production of the imported goods,
  - materials consumed during the production of the imported goods,
  - engineering work, research and development work, art and design work, as well as plans and sketches produced outside the EU and necessary for the production of the imported goods.

- c) honoraria, royalties and licence fees related to the merchandise being valued, which the buyer must pay directly or indirectly as a condition of sale of the goods valued – to the extent that these honoraria, royalties and licence fees are not included in the price actually paid or payable;
- d) the value of any part of the income from any further resale, disposal or use of the imported goods that accrues directly or indirectly to the seller;
- e) costs of transportation or insurance of the imported goods as well as the loading and handling fees related to the transport of imported goods to the place of their entry into the EU customs territory.

The **costs not included in the customs value**, provided that they can be extracted from the price actually paid or payable, are the following:

- a) the costs of transport of the imported goods after their entry into the EU customs territory;
- b) charges related to construction, installation, assembly, maintenance or technical assistance works, undertaken after the entry into the EU customs area of the goods such as industrial plants, machinery or equipment;
- c) interest charges resulting from the financing agreement concluded by the buyer and relating to the purchase of the imported goods, irrespective of whether the financing is provided by the seller or another person, on condition that the financing agreement has been made in writing and that – where required – the buyer can demonstrate that the conditions given below are fulfilled:
  - the goods have been actually sold at the price declared as price paid or payable;
  - the rate of interest claimed does not exceed the level for such transactions prevailing in the country where and when the financial operation was executed;

- d) fees for the right to reproduce the imported goods in the Union;
- e) buying commission;
- f) import duties or other charges levied in the EU by reason of the import or sales of goods.

The sales invoice is the principal commercial document serving the purpose of determining the transaction value of merchandise. The same applies to the elements added or subtracted in order to determine the customs value (invoice for transportation costs or assembling services, etc.).

**The transaction value of identical goods method** is used when the customs value cannot be determined based on the transaction value; the method comprises determining the customs value on the basis of the transaction value of identical goods sold for export to the customs territory of the Union and exported at the same or about the same time as the goods being valued. The goods are considered identical if they have been produced in the same country as the goods being valued and, when they are exactly the same, including their physical characteristics, quality and reputation.

**The transaction value of similar goods method** is used when the customs value cannot be determined either on the basis of the transaction value or on the transaction value of identical goods. The transaction value of similar goods method accounts for determining the customs value on the basis of the transaction value of similar goods sold for export to the EU and exported at the same or about the same time as the goods being valued. The goods are considered similar if they have been produced in the same country as the goods being valued and – without being similar in all respects – still possess similar characteristics and composition by which they can carry out the same functions and be commercially interchangeable with the goods being valued. While determining the similarity of goods, the quality, trademarks and goods' reputation should be taken into account.

**The unit price method** is used when the customs value cannot be determined with the use of any of the foregoing methods (the transaction value method, the methods of transaction value of identical or similar goods). The unit price method consists in calculating the value based on the unit price at which the goods imported, or identical goods



or similar goods, are sold in the EU in the greatest aggregate quantity to buyers not related to sellers. However, the following should be deducted from the unit price established in the way described above:

- a. commissions usually paid or agreed to be paid, or additions usually made for profits and general expenses (including direct and indirect costs of trading in these goods), related to the sales in the EU of imported goods of the same class or kind;
- b. costs of transport and insurance as well as associated costs incurred within the EU;
- c. the customs duties and other levies payable in the EU by reason of the importation or sale of the goods.

When the unit price method is used, the notions of identical and similar goods as well as the related parties (buyers and sellers) should be understood identically as in the case of the previously discussed customs value determination methods.

**The computed value method** is applied when the customs value cannot be determined with the use of the transaction value method, transaction value of identical and similar goods methods or the method based on the unit price. The customs value determined with the use of the computed value method is calculated as the sum of the following:

- a) the costs or value of materials and production or other processing employed in manufacturing the goods imported;
- b) the amount for profit and general expenses equalling the amount usually included in the sales price of goods of the same class or kind as the goods being valued, produced in the country of exportation for sales to the EU;
- c) the costs of transport and insurance of imported goods as well as loading and handling charges associated with the transport of the imported goods to the point of their entry into the EU customs territory.

**The residual valuation provision method** (also called the fall-back method or the derivative method) applies when it is not possible to apply any of the previously mentioned methods. This method does not provide

for the use of any specific way to determine the customs value of a merchandise, but requires that the customs value is determined on the basis of data available in the EU customs territory with the use of appropriate means consistent with the principles and general provisions.

**The customs value determined on the basis of this method cannot be based on the following:**

1. The selling price in the EU of goods produced in the EU;
2. A system providing for the acceptance for customs purposes of the higher of two alternative values;
3. The price of goods on the domestic market of the country of exportation;
4. The costs of production other than the computed value determined for identical or similar goods;
5. Prices for export to a country not being part of the customs territory of the EU;
6. Minimum customs values;
7. Arbitrary or fictitious values.

It is essential that the customs value determined with the use of the above method be based – to the largest possible extent – on other methods of valuation, which should be used with ‘reasonable flexibility’.

## **6.5. Incurrence of customs debt and guarantees**

### **6.5.1. Customs debt on import**

A customs debt on import is incurred as a result of placing non-Union goods, liable to import duty, under one of the following customs procedures:

- a) release into free circulation, including the release under the end-use provisions;
- b) temporary admission with partial relief from import duties.

A customs debt is incurred at the time of accepting the customs declaration. The debtor is the declarant submitting the customs declaration. In the case of indirect representation, a debtor is also the person on whose behalf the customs declaration is made. If the customs declaration, related to one of the previously mentioned procedures, is drawn up on the basis of information leading to the situation in which all or part of the import duty is not collected, the person who provided the information required for drawing up the declaration, and who knew or ought to have known that the information was false, is also a debtor.

**A customs debt is incurred when:**

- a) an obligation, the non-fulfilment of which causes the rise to the customs debt, is not met or ceases to be met;
- b) a customs declaration for the placing of goods under a customs procedure is accepted and subsequently it is found that a condition that governs placing the goods under this procedure or granting of a duty exemption or granting a reduced rate of import duty by virtue of the end-use of goods, was not actually fulfilled.

### **6.5.2. Customs debt on export**

A customs debt on exports is incurred as a result of placing the goods liable to export duty under the export procedure or the outward processing procedure and by acceptance of the customs declaration. The declarant is the debtor and, in the case of indirect representation, the debtor is also the person on whose behalf the declaration has been made.

## **6.6. Customs-approved use of goods**

From the moment any goods are brought into the customs territory, they are subject to customs supervision and fall under the control of customs authorities. The goods entering the customs office, or another place designated or accepted by the customs authorities, should be presented to the customs authorities by the person who has brought the goods into the Community customs territory or – depending on the actual situation – by the person holding the responsibility for transporting the goods after their entry.

The presentation of goods to the customs authorities is equivalent to notifying the customs authorities in due form about the entry of the goods to the customs office or any other place.

**Customs-approved use of goods**

All merchandise, both entering into any customs territory and taken out of this territory, should have its use defined. The customs-approved uses are:

- 1) placing of goods in a customs-free zone (CFZ) or a customs warehouse (CW),
- 2) abandonment of goods to the State,
- 3) re-export of goods,
- 4) destruction of goods,
- 5) placing of goods under customs procedures.

The following are among the duty suspension procedures:

- 1) customs warehousing,
- 2) processing under customs control,
- 3) temporary importation (or temporary admission) and temporary exportation,
- 4) inward processing,
- 5) transit,
- 6) export.

The customs procedures under the drawback system are:

- 1) inward processing under the drawback system,
- 2) outward processing.

The duty suspension procedures consist in the suspension of payments due, while the person granted the right for such a procedure is obliged to provide a guarantee in order to cover the amount resulting

from the customs debt that may be incurred on the goods subject to the procedure. The discharge of the suspension procedure takes place when a new customs-approved treatment or use is assigned to the goods under this procedure, or to compensating products or to goods processed under customs control (with the exception of transit).

#### **6.6.1. Entering the goods into customs free zones or customs warehouses**

Customs free zones (CFZ) and customs warehouses (CW) are enclosed parts of the EU customs territory, or designated spaces within this territory, where:

- a) non-Union goods, for the purpose of the application of import duties and the commercial policy measures applied in imports, are treated as being from outside the EU customs territory, on condition that they have not been released for free circulation or placed under any other customs procedures, or have not been used or consumed in a way non-conformant with the provisions of EU customs laws;
- b) the goods identified by specific EU provisions are subject – by virtue of their entry into a customs-free zone or a customs warehouse – to measures usually applied to exports.

**The Union Customs Code**, as a matter of principle, leaves the establishment of customs-free zones and customs warehouses in the hands of the Member States. The customs-free zones and customs warehouses are usually established with a view to:

- facilitating international transit of goods; the preferred location then should be in the vicinity of the crossing of major communication routes, e.g. near sea ports, airports, border crossings or in areas neighbouring major transit roads;
- developing exports and creating new jobs.

Such a construct attempts to combine the two concepts of the free zones' operation – as a place a) used only for the purposes of international transit, b) a place whose primary function is manufacturing related to the processing, treatment or refinement of goods.

The basic assumption behind this construct is the need to exploit the free zone concept fully, in particular as an instrument allowing governments to narrow the trade deficit and to lower the unemployment rates in a given region. The following circumstances are usually taken into account when CFZ and CW are created: the suspension of duty and tax payments, the suspension of commercial policy measures, the possibility to store transit goods before their re-exportation, the storage of goods and preparing them for sales as well as the exploitation of various measures related to the export of Community goods.

The delivery to a customs-free zone of goods intended for further exports outside the EU territory and placed under the exports procedures in the meaning of EU customs provisions, including those related to completing, packaging and the formation of collective consignments, is subject to a 0% VAT rate. The goods are entered into a CFZ on the basis of transport-related documents such as consignment notes, delivery notes, manifestos or dispatch notes; these documents should contain all the information necessary to establish the identity of the goods being entered.

The operators of the CFZ are responsible for keeping detailed records of goods (both entering into and taken out of the CFZ), which fall under the supervision of the customs authorities. The acknowledgement of the goods' entry into the CFZ may take the form of e.g. a print-out from the electronic register of the goods entered. For the purposes of a potential tax control, it is worth retaining the sales invoices, the storage contract concluded with the CFZ and, obviously, the acknowledgement of the lodging of the export declaration (card 3 of SAD or the electronic ECS confirmation)<sup>6</sup>.

The use of the CFZ instrument is advantageous for the user in the situation when he/she intends to export the goods and wants to gain the right to apply the 0% rate of VAT promptly.

**A Customs-free Zone** – a separated, uninhabited part of a larger customs territory, treated as a foreign territory, where a single customs system applies. The domestic and foreign economic entities can conduct there manufacturing and commercial activities, taking advantage of the tax and duty exemptions.

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<sup>6</sup> Customs declaration of goods can be made in writing on the Single Administrative Document (SAD) form or in electronic version i.e. the Export Control System (ECS), which is the EU system that supports electronic export declaration, and which replaced SAD.

**A Customs Warehouse** – a separated part of a customs territory, treated as a foreign territory, where enterprises can warehouse and store the foreign and domestic goods as well as re-pack, refine, treat, process, assemble or repair them.

#### **6.6.2. Abandonment of goods for the benefit of the state**

As abandonment to the State results in the transfer of ownership, only the owner of the goods may renounce his or her ownership rights. The customs authority may authorise the abandonment to the State without any fees other than import charges.

#### **6.6.3. Re-export**

Applies to non-Union goods which:

- after their entry into the customs territory have not been placed under any of customs procedures or
- have been previously placed under a suspensive procedure.

Re-exportation of goods placed under a custom procedure with economic impact requires presentation – together with the customs declaration – of all documents related to the placing of the goods under this procedure. Assignment of this customs-approved use may take place only if the merchandise leaves the Union's customs territory in the same state as it was in at the moment when the application for re-export was lodged. The re-export is deemed to have taken place at the moment when the goods actually depart from the Union's customs territory.

#### **6.6.4. Destruction of goods**

In practice, the destruction of goods is important from the point of view of the protection of human life and health, protection of the environment or public security. There are two procedures provided for in the destruction of goods:

- a) by application – the destruction can take place after the previous approval by a customs authority. The application should be made in writing, and the destruction of goods is supervised by a customs authority,
- b) destruction ex officio – takes place on the basis of a customs authority's decision and it is compulsory when:

- international agreements or other relevant provisions in force prohibit the possession, dissemination or trading in these goods and the customs authority cannot order the withdrawal of the goods outside the border or to the country's customs territory,
- where the subject of trading is goods hazardous or harmful to health or the environment, and international agreements provide that trading in or dissemination of these goods depends on the fulfilment of specific conditions and when neither the immediate withdrawal outside the border nor confiscation are possible.

## **6.7. Placing of goods under customs procedures**

The suspension procedure applies to non-Union goods in the following types of procedures:

- customs warehousing;
- inward processing under the suspension system;
- processing under customs control;
- temporary importation or temporary exportation;
- external transit.

The notion of 'customs procedures with economic impact' is of a rather conventional nature, and it is meant to indicate economic character of the procedures in question. In most cases, these procedures apply to entities conducting business activities and are subject to authorisation by customs authorities. The customs offices of entry, supervision and discharge can be involved in the course of these procedures.

### **6.7.1. Customs warehouse**

The procedure of customs warehousing is among the group of procedures with economic impact and suspensive arrangements at the same time. It allows for the warehousing of goods for which the right to apply the procedure in the customs warehouse area was granted, until the time when the goods fall under other customs-approved uses. The placing of



goods under customs warehousing procedure takes place on the basis of an application made in writing with the use of SAD.

The customs warehousing procedure allows for the warehousing of:

- a) non-Union goods, which during the warehousing period are not subject to import duties or commercial policy measures;
- b) Union goods which, by virtue of their placement in a customs warehouse, are subject to measures normally applied to exports of such goods.

The use of the customs warehousing procedure makes it possible for economic operators to postpone the costs related to customs and tax charges on goods in import until the goods are released for free circulation in the EU. Thus, an importer can bring in a larger amount of merchandise than needed for current production or distribution and subsequently release them in smaller tranches. The procedure for release into free circulation allows only a portion of the goods, which is actually needed at the moment, to be released into the Union's market, while the customs and tax charges due are incurred only in relation to the tranche of goods that actually exits the warehouse. The customs duties and VAT are thus paid only for the portion of goods actually released into the market.

The procedure is also used in order to avoid these charges if the goods will be subject to export without their release into the domestic market.

The use of the customs warehousing procedure can arise for a variety of reasons, depending on the character of a given warehouse:

- the warehousing of goods intended for further export – a transit warehouse,
- storage of goods until the actual market need for them occurs, without the obligation to pay customs charges previously – a credit warehouse,
- storage until appropriate procedures prior to intended export are cleared – an export warehouse,
- waiting out the temporary limitations or restrictions resulting from commercial policy measures – a temporary warehouse,

- in the case of agricultural goods, in relation to Common Agricultural Policy, when the goods are warehoused in order to obtain appropriate export subsidy at the time of the goods' exit from the warehouse – a pre-financed repayment warehouse.

An authorisation by customs authorities is required for the use of the customs warehousing procedure. It can be granted to any person intending to warehouse goods in a customs warehouse, on condition that the applicant meets all the criteria allowing the customs authority to consider that the procedure can be executed properly. The application for authorisation should be lodged not later than 30 days before the goods are declared for placing under the customs warehouse procedure. If a public warehouse is to be used, the storage contract should be attached as well. When issuing the authorisation, the customs authority may require that the applicant provide a guarantee to cover a potential customs debt which may be incurred for the goods placed under the procedure. There are no limits to the length of time during which the goods may remain under a customs warehousing procedure.

A customs warehouse means any place approved by and under the supervision of the customs authorities, where goods may be stored under the conditions laid down in customs laws.

There are two basic types of customs warehouses:

- 1) public – customs warehouses available for use by any person for the storage of goods.

Public warehouses are run by freight companies, customs agencies and other entities running their business activities in the field of chargeable storage of goods. Three types of public warehouses can be distinguished:

Type A – a public customs warehouse where the responsibility for the goods stored lies with the warehouse keeper;

Type B – a public customs warehouse where the responsibility lies with the depositor;

Type F – a public customs warehouse operated by the customs authorities.

- 2) private – customs warehouses reserved for the warehousing of goods by the warehouse keeper for his own use related to the warehouse keeper's economic operations.

Private customs warehouses are established by enterprises and are used for the storage of goods intended for their own business activities. In this case, the responsibilities lie with the entity operating the warehouse. Among the private warehouses, three other types can be distinguished:

Type D – where release into free circulation is made by way of local clearance procedures.

Type E – where storage takes place in a different location than the very customs warehouse (e.g. in special containers or external refrigeration plants).

Type C – the basic private warehouse used when neither storage type D nor E applies.

The goods placed under the customs warehousing procedure may undergo usual practices aimed at their proper preservation, improving their appearance or marketable quality, preparing for distribution or re-sale. However, an authorisation is required for the execution of such processes. They may take place on the premises of the customs warehouse or under the temporary removal procedure. The typical processes that goods may undergo are: sorting, sampling, labelling, repairs resulting from transport damage or stock-taking. The exit of goods from the customs warehouses, according to the user's order, in most cases means their release into free circulation or export outside the EU customs territory. The customs warehousing procedure may also end with placing of goods in a customs-free zone, destruction or abandonment to the State.

The above activities may result in minimising the costs of transportation of the imported goods or open the possibility to negotiate competitive prices or more efficient use of time needed for preparing the goods for distribution – without the necessity to incur the customs and taxation costs.

### 6.7.2. Processing under customs control

The processing under customs control procedure allows non-Union goods to be used in the customs territory of the EU in operations which alter their nature or state, without being subject to import duties or commercial policy measures. It also makes it possible that the products resulting from such operations (processed products) be released into free circulation at the rate of import duty assigned exclusively to them. An authorisation for processing under customs control is granted at the request of the person who carries out the processing, or arranges such processing.

Such authorisation is granted at the request of the authorised person lodged in writing on a special form used for inward processing, although a simplified form of the application is also provided, i.e. the acceptance of a customs declaration made in writing or with the use of electronic data processing techniques.

The benefits of the processing under a customs control procedure may be the following:

- lowering the production costs by minimising expenditures related to the import of goods intended for processing. It is of particular importance when the import duties on goods imported are higher than those applying to goods produced under this procedure,
- the possibility of placing the non-Union goods under processes that secure the compliance of the imported goods with the technical requirements conditioning the release of these goods for free circulation on the customs territory,
- avoiding the application to non-Union goods of commercial policy measures. They should apply only when the goods obtained in processing are subject to the release into free circulation procedure.

The placing of goods under the customs control processing procedure opens with the customs declaration lodging (under both the standard and the simplified procedures). The declaration should be lodged at one of the offices of entry for the procedure, identified in the authorisation document.

Processing means any operation leading to obtaining the products to which lower import duty rates apply than those applying to imported non-Union goods. Processing – for any kinds of goods, irrespective of

the rate of applicable import duties, means also such an operation that leads to securing the compliance of these goods with technical requirements which must be met when they are being released for free circulation. As there is no absolute obligation to place the goods under processing, it is possible that the goods – in the unaltered state – are assigned another customs-approved use or treatment.

The procedure of processing under customs control in relation to imported goods is discharged when the processed products or goods in unaltered state, or products processed partly (as compared with the degree of processing stipulated in the authorisation), are released for free circulation or another customs-approved use is assigned to them, and when all other requirements of the procedure are fulfilled. The procedure of processing under customs control should be completed within the so-called period for discharge, when the goods placed under the procedure, or the processed goods, should have a new customs-approved treatment or use assigned. The period of discharge, laid down in the authorisation document and allowing the time necessary for processing and sales of processed products, may be extended, even if the originally set period has already expired.

Under the procedure of processing under customs control, the collection of import duties on non-Union goods is suspended until the processed products are assigned a new customs-approved treatment or use.

### **6.7.3. Temporary importation or exportation procedures**

Temporary importation and temporary exportation are among the permitted customs procedures applied to goods imported to or exported from the EU customs territory. Temporary importation/temporary admission means importation into the EU customs territory of goods for a specific purpose and intended for re-export within a given time-frame. Temporary exportation means exporting goods for a specific purpose with the possibility of re-importing within a specified period restricted.

The temporary admission procedure when importing allows the use in the customs territory of the EU, with total or partial relief from import duties, of non-Union goods imported for a specified period of time and intended for re-export, without having undergone any change except that resulting from normal depreciation due to use. These goods are totally or partially relieved from duties and are not subject to commercial policy measures.

The temporary procedure with partial relief from duties is among the suspensive procedures and requires the appropriate authorisation. It applies to:

- a) goods intended for repair, refinement, working or processing,
- b) means of production and means of transport with the exception of passenger cars leased, rented or commissioned for use, brought in or sent outside in order to conduct business activities,
- c) means of transport other than those listed above,
- d) goods intended for testing (samples and models without commercial value can be cleared and relieved from duties).
- e) industrial models and designs,
- f) reusable packaging,
- g) goods intended for use at auctions, exhibitions or fairs.

Goods taken out of the customs warehouses or customs-free zones can also be eligible for temporary admission/temporary importation.

Declaring for temporary arrangements of the goods, whose type or quantity indicates their use in business activities, takes place by submission of a SAD document, with which an application identifying and justifying the purpose of temporary importation or exportation, together with the date by which the goods will be re-imported or re-exported, should be made. If required by the customs authorities, supplementing documents authenticating the purpose of importing or exporting (a contract with a foreign party, a description of industrial treatment or processing procedure the goods are to undergo, a document confirming participation in an event) should be annexed to the application. Additionally, only on request should other documents be attached (photographs, illustrations, samples) that may be useful for establishing the identity of the goods during the discharge procedure, if the description included in SAD document or in specifications or invoices is not sufficient.

The submission of an ATA carnet<sup>7</sup> also results in exemption from submission of the SAD document. The release into circulation in the Union's

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<sup>7</sup> The ATA carnet (Admission Temporaire/Temporary Admission Carnet) is used for the temporary import or export of goods. It is not mandatory but it simplifies customs clearances in dispatching and receiving countries that are parties to the Istanbul Convention.

customs territory or temporary export outside this area takes place by way of a decision which can be issued in the form of a SAD document – if the goods are intended for business activities, a proof of temporary admission, an ATA carnet or in the simplified form. The simplified temporary procedures apply (by entry in the appropriate departure or arrival registry) to sea-going ships, inland navigation vessels, aircraft and railway vehicles providing transportation links with abroad as well as the road vehicles belonging to domestic and foreign carriers. The simplified clearance procedures (without registration) also apply to vehicles in passenger traffic. The time for re-export or re-import in all these cases expires with the date of re-departure abroad or return from abroad of the person who declared the means of transport for clearance.

A decision on the temporary arrangement, issued in writing, should specify the date of re-export or re-import, the indication of the customs value as well as the duty and tax charges applicable and – in the case of export – the domestic value of the goods.

#### **6.7.4. Inward processing**

Inward processing is a procedure with economic impact, which allows for avoidance of payment of duties on goods imported from outside the EU. The inward processing procedure applies to non-Union goods that are entered into the EU customs territory in order to use them in processing procedures (such as assembling, repair or manufacturing).

Inward processing is applied under two basic systems: the suspension system and the drawback system.

Goods intended for inward processing under the suspension system are not liable to customs duties and to non-tariff measures. Customs duties are paid only when the goods (in the form of compensating products or goods in an unaltered state) are released for free circulation. It is at that time also that commercial policy measures are applicable to these goods, the ones in force at the moment when the declaration of release is accepted. The use of the procedure allows for inward processing in the Union's customs territory of:

- a) non-Union goods intended for re-export outside the EU territory in the form of the so-called compensating products,
- b) goods released for free circulation with repayment or remission of the import duties chargeable on such goods, if they are exported

from the customs territory of the Union in the form of compensating products.

In inward processing under the drawback system, the import charges on the goods imported in order to be placed under the procedure are collected and subject to later repayment, provided that specific conditions for such a repayment are met.

The appropriate authorisation may be granted only to a person established in the Union, on condition that:

- a) the applicant intends to re-export the goods or to export the compensating products,
- b) the import goods can be identified in the compensating products, with the exception of the situation when the compensating products are produced from equivalent goods,
- c) when the procedure allows for the creation of the most favourable conditions for export or re-export of compensating products,
- d) the non-Union goods have been declared for inward processing (under suspension or the drawback system) at one of the entry offices identified in the authorisation.

The goods undergoing the inward processing procedure should be processed according to the permitted processes catalogue, including: working of goods (erecting, assembling or fitting them to other goods), processing of goods and repair of goods (including restoring them and putting them in order), use of certain goods which cannot be found in the compensating products but which allow or facilitate the production of those products, even if they are entirely or partially used up in the process.

By way of the discharge of the procedure, the potential customs debt and its amount is identified. The holder of the authorisation undertakes the discharge procedure on his/her own and submits its results to the supervision office within 30 days of the expiry of the period for discharge. Under justified circumstances, the authorities may allow for an extension of this period. Basically, the procedure under the suspension system is treated as a procedure without collecting the duties and import charges, and the one in which a customs debt is not incurred. A customs debt may, however, be incurred, if the goods are not re-exported



but released into free circulation or if irregularities have been identified within the course of the procedure. The inward processing procedure under the suspensive system ends when the compensating products or goods in an unaltered state are re-exported, or when another customs-approved treatment or use is assigned to them.

#### **6.7.5. Outward processing**

Outward processing consists in temporary exportation from the EU customs territory of Union goods, processing them outside the EU and subsequent release into free circulation of the goods produced under these processing operations – with total or partial relief from import duties. The purpose of exportation is specifically the processing of goods and later release of products resulting from these procedures, into free circulation, thus enabling the exporter to benefit from the total or partial release from import duties. The procedure does not have a suspensive nature.

#### **6.7.6. Release into free circulation**

Release into free circulation – the principal procedure used in the importation of goods into the EU customs territory. The procedure assigns to non-Union goods the status of Union goods. Both businesspersons and those not conducting business activities may use the goods or resell them further, after the goods have been released into circulation.

Union goods are those wholly sourced on the EU customs territory, without the addition of goods imported from countries not forming the EU customs territory as well as goods imported from these countries and released for free circulation in the EU territory. The customs declaration for the release into free circulation procedure can be submitted in written, oral or another form. In order to assess the amount of duties due, the state of the goods and other calculative elements are taken into account. The declarant should submit invoices, specifications of goods or loading lists, permits or other documents (if required in relation to import), which can constitute the basis for the calculation of taxes due, certificates issued by the producer or an authorised research centre, declarations containing data allowing the assessment of the customs

value of the goods and the documents required for the application of preferential tariff arrangements.

**The import customs duties** are calculated according to the state of the goods and their customs value on the date of the customs declaration acceptance and according to the tariff rates in force on this date. The customs declaration is made on the SAD 4 form. If the consignment contains goods falling under different tariff classification codes, the customs authorities may, on request of the declarant, authorise the collection of import customs duties on the entire shipment. A number of suspensive procedures, consisting in the temporary postponement of duties payment, previously described, are linked with the release into free circulation procedure.

When the **EU supervision of goods** is required, the Member States provide the Commission with the data extracted from customs declarations for release into free circulation and exports declarations at least once a week. The goods released into circulation lose their status of Union goods when: a) the declaration for release is invalidated, b) the import customs duties for these goods are subject to refund or remission under the inward processing procedure, c) goods that are defective or non-compliant with the contract are returned and the customs charges are subject to repayment or remission.

#### 6.7.7. External and internal transit

The essence of external transit consists in the movement from one point to another within the EU customs territory of both non-Union goods on which the duties, other charges and commercial policy measures have been suspended, and of Union goods subject to these payments, which have been, however, suspended due to the goods movement to third countries and after the customs formalities in exports have been fulfilled. The transit procedure does not require prior authorisation.

Forms of transit procedure:

- with the application of the external community transit procedure,
- with the use of a TIR carnet,
- with the use of an ATA carnet used as a transit document,
- with the application of the Rhine manifesto,

- with the application of NATO Form 302, provided for by the Agreement between the Parties to the North Atlantic Treaty Organisation regarding the status of their force,
- with the use of postal services.

Transit with the use of a TIR carnet may only be performed if the movement either starts or ends in a third country; it concerns the shipment of goods which are to be unloaded within the EU customs territory and which are shipped together with goods intended for unloading in third countries. TIR transit concerns the situation where an intra-Community movement of goods goes via a third country's territory.

The ATA Convention lists the following **categories of goods** that may be shipped with the use of the ATA carnet: commercial samples and designs exported for marketing purposes or market research, or the demonstration of goods before concluding a contract. The list also includes goods intended for use during fairs and exhibitions: all kinds of exhibits, show exhibit booths and decorations, etc. The following types of professional equipment are also included in the list: film, television and video equipment, theatrical props, musical instruments, sports equipment, research and scientific equipment, tools, etc.

The ATA carnet is a special international customs document which eliminates the customs procedure related to temporary importation and exportation, because a user does not have to fill in a SAD document, customs declaration or provide a deposit at all borders crossed. The carnet is valid for 12 months from the date of issue and the validity period cannot be extended. ATA carnets are available to both legal and natural persons. The authorised person (subject responsible) has to: submit the customs declaration with necessary accompanying documents, present the complete Carnet within the period specified in the appropriate customs office and lodge a guarantee. A guarantee is not required in the case of sea and air freight, freight transport on the Rhine and Rhine inland routes, transportation via pipelines, and freight conducted by Member States-based railway operators.

The authorised person is obliged to lodge a guarantee securing the payment of a customs debt or other charges that may be incurred on the goods. The guarantee should be lodged at the customs office of exit where the goods are being declared and should be valid throughout the EU. The guarantee can be lodged in respect to a single transit

– a single guarantee (of up to 7,000 €) or to a number of transit operations – as a general guarantee.

The **internal transit procedure** allows for the transfer of Community goods – without changing their customs status – from one point in the customs territory of the EU to another though the territory of a third country.

The procedure applies to the transportation of Union goods and results in the suspension of measures normally applicable in the case of the transfer of goods within the EU customs territory, if the goods are consigned through the territory of one or more EFTA countries, according to the provisions regulating the Common Transport Policy. This procedure does not apply when the goods are carried entirely by sea or by air.

The internal transit procedure in a way facilitates transit operations, because it allows that the goods temporarily leaving the EU territory retain the Union goods status and because it eliminates formalities on the borders between EU and EFTA countries.

Two documents are used in the internal transit procedure, namely: **T2** (for Union goods) and **T2F** (if the goods from outside of the Union's fiscal area fall under the transit procedure). The procedure of internal transit 'T2F' applies to the movement of Union goods which are consigned to, from or between the non-fiscal areas of the customs territory of the EU. The non-fiscal areas of the customs territory of the EU are those areas where the provisions of Directive 77/388/EC do not apply (the VAT Directive).

Opening of the CTP (common transit) procedure takes place in a customs office of a non-EU country with the issue of customs declaration documents (SAD), and the lodging of a security guarantee and customs charges, if applicable. On the borders of the countries neighbouring the EU customs territory, only the presentation of documents and guarantees issued in non-member countries is necessary. These documents are valid until the moment of the goods' delivery to the customs office of the destination in the country where the importer is based.

### 6.7.8. Exports

The nature of this procedure consists in the departure of Union goods from the EU customs territory. The pre-departure formalities that relate to the export customs duties must be fulfilled and commercial policy measures, if relevant, should be also applied.

The goods placed under the export procedure remain under the customs supervision until they depart from the EU customs territory. However, they must leave the EU customs territory in the same state as at the moment of lodging the original export declaration. Additionally, if the goods do not leave the EU customs territory, the exporter is obliged to notify the customs office about this fact without delay and to return to this office Card 3 of the declaration. The customs declaration should be lodged at the customs office relevant for the seat of the declarant or for the place where the goods were packed or loaded into the export consignment.

The 'exporter' means the person on whose behalf an export declaration is made and who is the owner of the goods, or who has a similar right of disposal over them, at the time when the export declaration is accepted. Where ownership or similar right of disposal over the goods belongs to a person established outside of the EU, the exporter is considered to be the contracting party established in the EU, pursuant to the contract on which the export is based. There are, however, exceptions to this rule:

- a) in the case of subcontracting, the export declaration can be lodged at the customs office relevant to the seat of the subcontractor (e.g. when the exporter has purchased the goods from the subject to which he/she has also contracted out the exportation outside the EU customs territory – in this case, the export declaration can be lodged at the customs office with the local competence relevant for the seat of the subcontractor);
- b) when, for organisational reasons, there is no possibility to apply the above rule, the export declaration can be submitted at any customs office competent to accept the declarations in the Member State in question. Such a situation may take place when, for example, the customs office relevant to the seat of the declarant is not competent to accept declarations on certain types of goods;
- c) for duly justified reasons, the declaration may be accepted in a customs office different from that mentioned above. Since EU law does not regulate the cases discussed here, each case is subject to individual assessment. For example, a justified exemption from the rules could take place in the situation when the rules, if applied, would lead to economically unjustified costs to be borne on the part of the exporter.

## 6.8. Customs declaration with the use of the SAD

The customs declaration for export procedure should be made in writing and lodged at the customs office of export with the use of the SAD document consisting of cards 1, 2 and 3. The documentation workflow is as follows: Card 1 is intended for the customs office at which the customs declaration has been lodged, Card 2 is used for statistical purposes, while Card 3 is indented for the exporter. After the formalities at the customs office are completed, this card is returned so that it could be presented at the customs office of exit. This office will supervise the departure of goods for the territory outside the EU customs area and will provide confirmation of the goods' departure from the EU customs territory.

The competent offices of exit are respectively: 1. in the case of goods departing by railroads, postal services, sea or air – the customs office with local competence relevant to the place where goods are taken over by a railway company, post office, air or sea navigation company within a single contract for freight to a third country; 2. in the case of goods transferred by transmission lines (gas, oil, electric energy) – the customs office designated by the Member State in which the exporter is based; 3. in the case of goods transported by other means or under circumstances not covered by point 1. or 2. – the last customs office before the actual exit of goods from the EU customs territory.

In **road transport**, after presentation of the goods and Card 3 of the SAD document at the customs office of exit, this office supervises the departure and provides the confirmation of departure outside the EU customs territory on Card 3 of the SAD document, and returns the Card on request of the declarant. However, the declarant may express the wish to get back the Card and to obtain the confirmation of departure in another way. The confirmation of departure is made by placing on the back side of Card 3 of the SAD document an official stamp with the date and name of the customs office. The duly confirmed Card 3 is returned to the person who presented the Card with the goods (exporter, declarant, representative or carrier) or, if this is not possible, to the person named in the SAD document (i.e. person based in the territory under local competence of the customs office of exit).

When the goods are transferred by postal services, by railway, sea or by air, the competent office of exit is the one with local competence for the place where the goods were taken over by the carrier under a single contract for freight to a third country.

As far as regular navigation lines, direct transportation or direct flights to the third countries of destination are concerned, if the operators are able to guarantee (with the use of other means) the appropriate execution of the procedure, the annotation 'Export' is not required.

In the case when goods previously released for export have not actually left the Union customs territory, the exporter has to notify immediately the customs office of export (at which the declaration was lodged) and return Card 3 of the SAD document. However, when goods are shipped by railway, post, sea or air, or if the transfer involves transit, if the change in transport contract occurs and the goods previously indented for unloading outside the EU are actually delivered to an EU destination, the execution of the changed transport contract is subject to the authorisation by the customs office of export or (in the case of transit) by the customs office of exit, after Card 3 of SAD is returned.

If the confirmation of departure on Card 3 of SAD has been provided by an internal customs office, the release of goods for actual departure outside the EU territory by the border customs office is not conditioned upon the presentation of Card 3 of SAD, as this Card is intended for the exporter. The documents accompanying the goods at the border customs office are shipment documents with the 'EXPORT' annotation, transit documents or equivalents and – in the case of goods on which the excise duty has been suspended – also the accompanying administrative document.

If the goods released for exportation have not actually left the EU customs territory, the exporter is obliged to notify the customs office of export (at which the procedure was declared) and return Card 3 of the SAD document without delay.

Generally speaking, export and import documentation includes sales invoices, packing lists, transportation documents (bills of lading, air way-bills, CMR or CIM consignment notes), certificate of origin and any other specific documentation required by the buyer, financial institutions, letter of credit terms or by regulations of the importing and exporting countries. It is worth stressing that, nowadays, the paper forms of those documents are being replaced by electronic forms. It saves time and the cost of international transactions.

### **Questions and assignments**

1. Name the methods for determining the customs value of goods.
2. When do the preferential and non-preferential rules of origin apply?

3. Name the possible customs-approved uses of goods.
4. What is customs value?
5. Describe the requirements for goods to be disposed of or destroyed.
6. What does 'placing under a customs procedure' mean?
7. Name the types of customs procedures suspending the collection of customs duties.
8. What are the benefits of processing goods under customs control?
9. What documents are used in export and import customs clearance?

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# Chapter 7

## Electronic business

Anetta Kuna-Marszałek

### 7.1. The substance of the “new” economy

E-business has become a day-to-day reality of the modern economy. Although the first virtual enterprises emerged as late as the mid-1990s, nowadays, many of them are amongst the world’s largest companies. They owe this rapid growth to technological progress (especially in the field of IT and telecommunications), which paved the way for on-line sales to millions of firms. The Internet revolution also contributed to the emergence of the so called “new” economy, in which knowledge plays the key role.

To start with, the term “new” economy was first used to describe the economy of the United States in the second half of the 1990s, and referred to the economic prosperity experienced at that time (high GDP growth rate, increasing productivity, low inflation, low unemployment rate). Being perceived as a leader of change, the United States was quickly joined by highly developed countries of Western Europe (the United Kingdom, Scandinavian countries, Germany) and highly industrialised Asian economies (Japan, Hong Kong, South Korea). The term “new” economy was also used to distinguish between the markets from the times before and after the digital revolution.

Apparently, “knowledge-based economy”, a notion defined in various ways in the literature, is a more precise equivalent of “new” economy. The OECD (1996, p. 7) defines it in very general terms as an economy “directly based on the production, distribution and use of knowledge and information”. Powell and Snellman (2004, p. 199), in turn, describe it as production and services based on knowledge-intensive activities that “contribute to an accelerated pace of technological and scientific

advance as well as equally rapid obsolescence". It is worth stressing that all authors consider knowledge to be a product and a stimulant of economic growth.

The "new" economy is also referred to as a new paradigm, e-economy, cyber economy, Web economy or a digital economy. The literature in this area uses these terms synonymously. Such notions highlight a vital aspect of the "new" economy, i.e., the fact that it is a product of the digital revolution, which has also transformed society from a post-industrial one into an IT one. This context has put communication in the spotlight. Communication lays the foundations of social order and, thanks to "technologization", it was capable of introducing changes into other areas, such as business, finance, medicine, etc. (Kelly 2001, Quah 2003, Engelbrecht 2003).

Some pertinent features distinguish the new economic order from the one we had previously:

1. It is based on knowledge generated by skilled labour and educated technicians as well as conscious consumers. Knowledge, however, quickly becomes obsolete due to the pace of changes in the economy. That forces out the need to learn continuously and favours generating skills and information as well as their practical application;
2. The virtual economy is a key component of this order. Technological progress enables real, physical objects to be changed into virtual ones (virtual enterprises, offices or universities), which fundamentally changes the relationships among partners and the rules of doing business;
3. The new order is global. Trade in goods, services, flows of capital and technology have all been globalised. The Internet and other modern technologies know no borders;
4. Innovation plays a critical role and it is influenced by all spheres of social and economic life;
5. Electronic technologies and techniques designed to generate, receive, store and use information with a view to acquiring and maintaining a competitive advantage in the market are applied at a dynamically growing scale;

6. Information is continuously analysed and transmitted to any location at decreasing cost. It improves efficiency in all areas of the economy, from design, production and trade to marketing activities;
7. Enterprises are increasingly more willing to engage in business networks. Such relationships are based on cooperation, mutual trust and partners' belief that only by acting together can they be successful in the market. Thus, competition is transferred to the level of networks;
8. Value chains of individual enterprises have become disintegrated (outsourcing). That opens up collaboration opportunities to geographically distant entities, independent in terms of their ownership;
9. The consumer has become a producer. Extremely far-reaching product personalization results in a situation where the customer develops a product, selects its parameters, aesthetics, etc.

Using short terms and expressions, Peters (2005) demonstrates in a simple way how the economy has changed. To him, the transformations that have taken place totally contradict the previous order. The columns in the table below contain exact opposites: centralization – decentralization, defence – offence. Peters shows that from an organised, slow, and monotonous economy dominated with centralization, nepotism or conservatism the world is shifting towards openness, creativity, focus on knowledge and achieving goals. All these changes take place dynamically and there are no limits to them.

**Table 7.1.** Peters' comparison of the "old" and "new" economies

"Old" economy Socialists	"New" economy Free Market Democrats
1	2
Conserve	Destroy
Nepotistic hiring	Creative recruitment
<i>Political correctness</i> prevails	Dissent flourishes
Tortoises	Hares
Seniority	Meritocracy

**Table 7.2.** (cont.)

1	2
Centralize	Decentralize
Respect the administrators	Honour the entrepreneurs
Defence	Offence
"Bigger is better"	"Better is better"
Avoid defeat	Obsess about victory
Strive for uniformity	Strive for excellence
Servants of stability triumph	Masters of instability rule
Best practices	New practices
Ready. Aim. Fire.	Ready. Fire! Aim.
Order and obedience	Disorder and disobedience
Closed tomb	Fling open the windows to the "Gales of Creative Destruction"

**Source:** Peters (2005, p. 43).

When comparing the old, i.e., the traditional economy, with the new one we note that the latter is much riskier and unstable. Its future shape is hard to predict as it is exposed to dynamic changes from the outside. That implies a significant risk, which must be taken if an enterprise wishes to generate satisfactory profits and successfully operate in the market.

**Table 7.2.** Success factors in the "old" and "new" economies

"Old" economy	"New" economy
Foreseeable operating mode	Available to all
Balanced, based on geographical factors and capital	Changes and dynamics
Positioning	Value migration
Long-term planning	Real time action
Protection of products, markets and distribution channels	Cannibalization of products, markets and distribution channels

"Old" economy	"New" economy
Anticipating the future	Shaping the future or adapting to it
Encourages repeatability	Encourages experiments
Detailed action plans	Managing options
Structural, formal alliances	Networks of informal links
Failure aversion	Failure is expected
Effects and benefits loosely connected	Direct connection between risk and benefits

**Source:** Based on Bryl (2013, p. 36).

By identifying the "new" economy with information and telecommunication technologies (ICT) we divide the economy into sectors closely connected with ICT and traditional ones, although the gap in technological potential between the two is closing as a result of integration and diffusion. According to Marcinkowski (2010, p. 26), the coexistence of the traditional and "new" economy leads to innovation also in low-technology sectors, which, by definition, are not linked with the "new" economy. The ability of enterprises to transform and configure knowledge, technology and semi-products generated outside of their industry is decisive in this case. The success of high-tech enterprises involves collaboration with firms from the traditional economy. The coexistence of industries which use ICT technologies side by side with those who do not use them is becoming increasingly clear.

## 7.2. Definition of e-business and related terms

E-business, otherwise referred to as online business, is commonly defined as a business model based on broadly understood information and communication solutions, in particular on Internet applications. The literature devoted to this subject defines the phenomenon more precisely. For example, IBM, who was the first to define e-business, calls it a secure, flexible and integrated approach to delivering differentiated business value by combining the systems and processes that run core business operations with the simplicity and reach made possible by Internet technology (Chmielarz 2007, p. 15). In this approach, e-business becomes supplementary to traditional business operations.

On the other hand, Castells (2003, p. 90) and Kotler (2003, p. 40) stress its network aspect and claim that at the heart of e-business there is an interactive connection between producers, consumers and service providers based on the Internet and digital technologies. Thus, we can say that electronic business covers trade, marketing, logistics, production, services and financial operations, i.e., the entirety of electronic commercial transactions as well as all internal mechanisms of business organisation, which enable business to be done electronically. Moreover, it includes internal and external communication, external processes, and individual services offered to customers and partners (Kański 2005, p. 31).

Enterprises engaged in online business improve their productivity as they apply technology at all stages of cooperation along the value chain. Their higher productivity and efficiency are effects of improved business processes, better customer service and cost reduction.

We can identify four stages of online business development in an enterprise (Nowakowski 2006, pp. 35–36):

1. Presence in the network – a firm which has so far operated traditionally makes an attempt to do business over the Internet. It creates its own website to publish marketing and advertising materials. It also starts using an electronic mail system in contacts with customers and other businesses;
2. Business on-line – a firm starts using the network to interactively contact the environment, not just customers and business partners, but also to manage its employees;
3. Integrated business on-line – IT systems become integrated within the management function, there is an electronic system of receiving orders and executing commercial transactions and various systems that support ICT (network) systems such as CRM<sup>1</sup> (*Customer Relationship Management*) to manage relationships with customers;
4. Fully fledged e-business – the internal IT system is adapted to work on-line, all business operations are transferred to the Internet.

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<sup>1</sup> CRM is a modern solution or a management model designed to best meet customer needs. The solution is based on building internal and external customer relations that will increase an enterprise's profit and productivity.

Electronic business is connected with more general matters such as the online economy (e-economy), IT society (e-society), online administration (e-government), online commerce (e-trade/e-commerce) as well as with some narrow areas, i.e., online banking (e-banking), Internet marketing (e-marketing) or distance learning (e-learning). Apparently, although online commerce is defined in various ways, it is the closest to the idea of online business. For example, the UN interprets it as a phenomenon covering a wide range of issues in international trade. Regulations on e-commerce cover all information in the form of electronic data used in the context of trade.

The OECD defines electronic commerce as “business conducted over computer networks, such as the Internet, with related infrastructure.” Such an approach limits e-commerce only to online transactions. However, the best known definition is the one proposed by the WTO, according to which electronic commerce is about production, advertising, sale or distribution of products by electronic means. In order to classify a particular business as e-commerce it must use electronic media in contacts with its market environment (customers, suppliers, existing or potential competitors, public administration, trade unions, political parties, NGOs, the media, lobbying groups).

Electronic commerce is not only about concluding transactions over the Internet, it involves an entire spectrum of trade-related activities, such as customer service, payments and distribution. In other words, new technologies change not only the technical aspect of trade but also the relationships between the seller and the customer. Key differences between traditional and online trade are presented in Table 7.3.

**Table 7.3.** Differences between traditional and online trade

Criterion	Traditional trade	Online trade
1	2	3
Media	direct, face to face communication using intermediaries or documents sent by mail, through messengers, phone, fax	Internet communication dominates: electronic mail, Internet browsers, website content + links, portals and other communication tools, potentially temporarily supported by traditional media



Table 7.3. (cont.)

1	2	3
Flexibility	low flexibility, problem in shifting from one activity to another, with the change of assortment or its expansion exacerbated by numerous administrative restrictions	high flexibility resulting from the role of a market intermediary; unfortunately connected with the need to make some technical moves in the market (advertising the change, linking up to other websites, developing own website, etc.)
Business logistics	goods manufactured or stored locally, limited scope of business or the need to run many locations where goods are manufactured and distributed	business is not linked with manufacturing, goods are sent directly to the client from its own or external wholesale establishments
Sales logistics	vertical structure, a chain of intermediaries, client needs to reach an outlet which is open at specific hours	flat structures, client equipped with adequate hardware may enter into a transaction from home 24 hrs a day
Forms of payment	traditional: cash, credit card, cheque; anonymity of purchase and sales, universal use of various forms of sales, problems with the exchange of some currencies used in certain territories, generally approved level of security	other than traditional: cash on delivery, wire transfer, credit card, smart card, micropayments, electronic money; questioned universality as it requires appropriate infrastructure, security level considered lower than traditional (but continuously improved)
Sales parameters	dependence between the location of an outlet and the density of sales network and the purchase price, which is due to limited availability of goods and services. Regional differences connected with geographical location	as a result of globalisation, price competition forces out little differences in price. Price differences may be mitigated by difficult supply conditions (distance). The lowest prices are achieved in trading in intellectual assets (no custom duties, cost of transport, etc.)

Source: Chelstowski, Szewczyk (2012, p. 24).

As we have already mentioned, the term e-business is linked to the following notions:

- e-society – a society in which each citizen has access to ICT technologies (computers, Internet and other networks, phones, smartphones, tablets, servers, terminals, smart TVs), is able to use ICT to smoothly acquire credible information to best meet her/his goals, and is aware of such a possibility (Żelazny 2013, p. 9),
- e-government – using ICT in public administration is closely linked with organisational changes and the acquisition of new skills to improve the quality of offered public services, enhance citizens' involvement in democratic processes and support State policy (European Commission 2015),
- e-banking – services that enable authorised access to a bank account using electronic devices: computer, ATM, phone, terminal and telecommunication lines (Polish Financial Supervision Authority 2010, p. 5),
- e-marketing – managing and delivering marketing activities using electronic media, such as websites, e-mail, interactive TV, IPTV (*Internet Protocol Television*), and wireless media in combination with data on customers' profiles and behaviours (Chaffey et.al. 2010, p. 10),
- e-learning – a teaching method that exploits the possibilities offered by modern ICT technologies (Stecyk 2007).

In other words, e-business also encompasses the substrategies for e-commerce, e-procurement and e-organization.

### 7.3. The Internet as an e-business environment

The internet is a unique medium of communication and human activity, different from traditional channels of social communication. Fundamental features that distinguish it from other communication media are (Szulc, Kobyłański 2014, p. 25; Korzeniowski 2012; Chełstowski, Sze-wczyk 2012):

- two-way impact (a user may be a sender and a recipient at the same time),

- individual message (the content changes depending on the client's needs and interests),
- dispersed topology (lack of a clear centre),
- multimedia and interactive approach (ability to convey messages in different formats, from text through speech and vision to audio-visual messages; direct supply of a bigger number of incentives stimulates memorising a product, recognising it, and it better associates a product with a particular enterprise),
- flexible times (communication is available 24/7),
- continuous improvement of offered services (detailed product description, the use of electronic payment, shortening the lead time),
- very wide scope of influence (due mainly to being a part of various media platforms: telecommunication, TV, etc.),
- selectivity (special ability to address the right message to people representing desired features).

The above mentioned advantages of the Internet are primarily relevant to small and medium-sized enterprises, which should seek development opportunities in digital business. The Internet may help them to partly level the playing field in competition with large companies. On top of that, being present in the network facilitates easier adjustment of their business offer and sharing information relevant to customers. A website enables goods to be purchased, bookings to be made, a contentious issue to be explained or appointments with a representative of a firm to be made. Internet technologies have opened access to cost-effective tools that support business activities and processes. It is possible for firms to not only reduce their operating costs but they are also able to operate at an unprecedented scale and often expand internationally.

Internet technologies facilitate business-to-business (B2B) collaboration and significantly improve business communication. Electronic B2B platforms help large enterprises buy from various, smaller suppliers instead of from some large ones. The Internet reduces the cost of communication, increases convenience and shortens response time, which is particularly important in transactions with geographically dispersed customers.

The Internet also allows companies to identify a new competitive advantage and impacts their development and business dynamics. It changes the patterns of rivalry between competitors. The problem is explained in detail in Figure 7.1, which presents components of Internet position and competitive power.

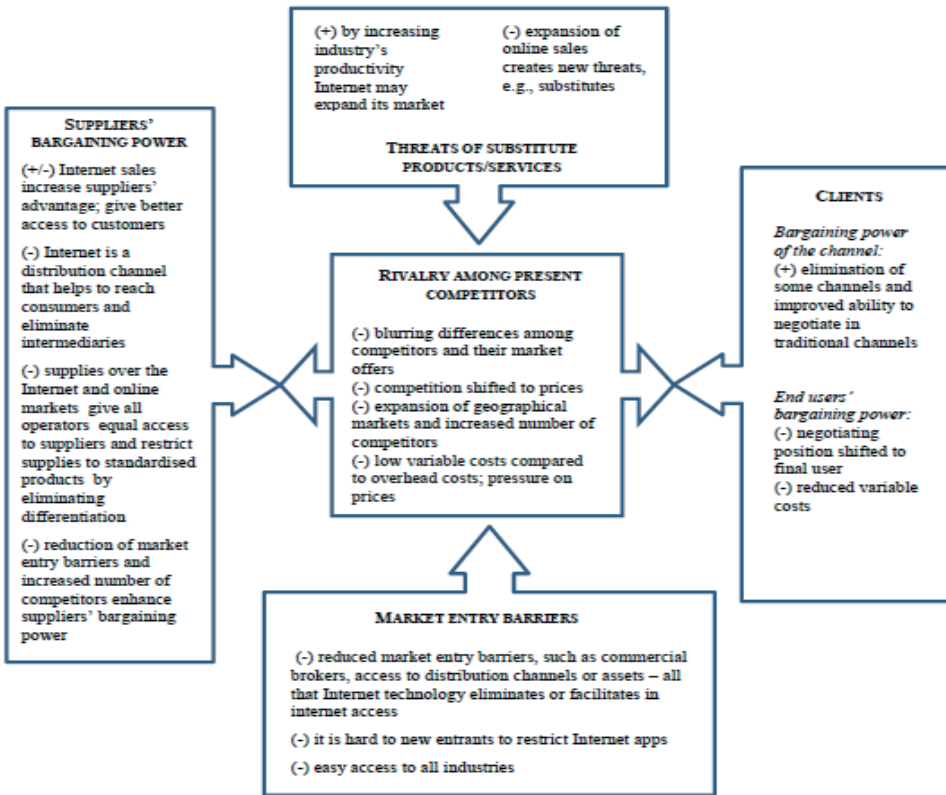


Figure. 7.1. Components of Internet position and competitive power

Source: Szulc, Kobyłański (2014, p. 28)

Both in Europe and globally, the Internet is considered not only an important element of improving innovation but also one of the key determinants of powerful and stable economic growth in the times of the global economic crisis. Reports of the European Court of Auditors or the European Commission stress that the implementation of ICT technologies in business and trade is of paramount importance for the improvement of

growth perspectives and the competitiveness of economic operators in Europe. It also generates new jobs (European Court of Auditors 2014, p. 14; European Commission 2013, p. 5).

## 7.4. E-business models

Increasingly more firms are taking advantage of business opportunities opened up by the Internet. However, the degree to which they do so usually depends on the enterprise's profile, e.g., IT service providers are almost automatically involved. To many firms, the network is a communication tool to reach external partners, an advertising platform or an additional outlet for their goods. By implementing an Intranet, many enterprises have improved their internal communication.

The Internet and its use have substantially changed existing business models. First and foremost, they have been transferred to a virtual level; some of them disappeared, others merge and intertwine producing new forms of business operations in cyber space. The e-business model identifies ways in which any firm that uses the Internet wishes to secure profits from its operations in the network. At the same time, it specifies the mechanism in which customer value is generated and delivered within a given type of business. The model is composed of activities directly related to the network and going beyond it.

As we have already mentioned, the rapid development of e-business, mainly e-commerce, and the popularity of online purchases (see the box) have increased the number and diversity of virtual business models. Firms are looking for new solutions, actively following changes in the business environment. Nowadays, "ordinary" e-stores, which merely mirror a traditional business, stand little chance of success unless the owner undertakes risk and implements a non-standard solution or innovation. Obviously, in e-business such a move will quickly find followers, however, economic rent of a pioneer in the market may facilitate maintaining competitive advantage.

### **Poles' purchases online – who buys online, how often and what?**

Data from the Central Statistical Office of Poland (GUS) demonstrate that in 2014, 74.8% of households were connected to the Internet and 34.2% people aged 16–74 purchased online. The most often purchased goods were sportswear and sports equipment (20.7% of the surveyed population) and products classified as other equipment (furniture, vehicles, household equipment,

garden and hobby items, tools, toys, jewellery, artworks and knick knacks – 14.2%). The smallest group of Internet users ordered films and music. Studies also show that enterprises themselves more and more often use the Internet for commerce, with almost 23.6% of surveyed firms placing orders for goods and services over the Internet while ca. 11.7% receive orders online. A study conducted by Newsweek magazine shows that young people (age group 25–34) buy online the most often. Almost 78% of them buy over the Internet at least once a quarter. In the age group 35–49 purchases online are made by ca. 76.7%, and in the age group 50+ by ca. 63.8%. Although Poles have increasingly more trust in e-commerce, they do not spend much online. As many as 78.3% spend no more than PLN 250 per month. The trend is clear irrespective of sex, age or residence. Poles shop online for two main reasons: to save both time and money. According to the respondents, the convenience of receiving goods at home and the vast selection of goods are also relevant. The opinion polls of CBOS (the Public Opinion Research Centre) show that between 2008 and 2014, online purchases grew in popularity. In 2008 those who stated they had made even a single purchase online represented one fourth of the population while nowadays almost every second Pole buys online (47%). Almost one third of Internet users have experienced selling online at least once. Young age and higher education are factors contributing to buying online. However, access to paid content continues to remain relatively unpopular. Not even one in ten Internet users decides to acquire it.

Source: *Spółeczeństwo informacyjne w Polsce w 2014 r.* (2014); Rogosz (2015); CBOS (2014).

It is worth stressing that e-business models increasingly link various groups of sellers and clients even more closely<sup>2</sup>, enabling cost reduction and mastering information flow among involved parties. In other words, these models evolve and move toward networks of linkages, in which producers, suppliers or business partners and consumers seek one another and merge dynamically, often only for the time needed to execute a business transaction or to attain other intended business goals (Nojszewski 2007). Examples of such solutions include virtual exchanges, electronic markets or value chain integrators.

<sup>2</sup> For example, an IT specialist who holds the ownership rights to software (application) places it free of charge on an Internet platform. His remuneration comes directly from the platform operator who charges end-users depending on the intensity with which they use particular functions of the app (standard and non-standard). At the same time, the same IT specialist receives income from the operator of advertising platform. The remuneration depends, inter alia, on the number of users who have filled out a contact questionnaire or on the demand of advertisers for a particular target group, which includes consumers using this app (see, e.g., Ministry of Administration and Digitization 2012, p. 23).

In the literature devoted to this area, we can come across many classifications of e-business models but none of them is exhaustive. The reason is that the Internet and the IT sector as such develop very dynamically constantly generating new changes, which leads to difficulties in systemising the existing e-business models. How the Internet is used in business may be one of the classification criteria, based on which we can distinguish (Szpringer 2012):

- transferred models – business models transferred from the real economy to facilitate and improve business processes, e.g., Internet shops open 24/7, which often offer a wider assortment of goods;
- innovation models – business models which could not operate outside of the Internet, e.g., browsers or other formats which use technological progress to meet clients' needs and gain a competitive advantage.

The classification of Internet business models is also based on the division into four components (Szpringer 2012 after: Wirtz 2011, p. 681 and the following; Bächle, Lehmann 2010, p. 12 and the following):

- content,
- commerce,
- context,
- connection.

Content refers to digital content, e.g., news on-line, downloading music or movies. We can find here traditional publishers and media as well as many new firms, such as Host-Service-Providers (YouTube) or Peer-to-Peer<sup>3</sup> services (Napster, Freenet). This segment of e-business models is an extensive one and it can be found in many sectors of the economy (e-information, e-entertainment, e-infotainment, e-education, etc.).

The second component – commerce – covers online sales and all related activities. It includes establishing business contacts and assistance in negotiating and concluding contracts (e-bargaining, e-transaction, e-retailing, e-payment, e-delivery). It brings together trade portals

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<sup>3</sup> Model of computer network communication that grants the same authorisation to all hosts.

(esources, Covinsit), e-stores and e-malls<sup>4</sup> (eCrater, Amazon), as well as online auctions (e-Bay, allegro), and producers of goods and services.

The context component is about classifying and systemising information (coming from various sources), personalised from the point of view of the needs of a single customer, depending on the location or source (e.g., Google Finance, Yahoo! Finance). The most important in this component are browsers and catalogue operators (Google, Yahoo!, MSN), who enable simple and advanced searches and the indexing of Internet resources in accordance with users' expectations (e-bookmarking).

The connection component includes primarily social networks (Facebook, Twitter) and related services, e.g., the exchange of opinions about products and services, or hobby forums.

As we have already mentioned, there are many e-business models. The formats most often defined in the literature include:

- **e-shop** (online store) – one of the most basic and popular models used to sell products or services via the Internet. Its benefits include reduced operating costs, lower prices, more clients and additional outlets for goods and services;
- **e-auction** (online auction) – with the bidding mechanism as its main function. It enables a big number of bidders who do not have to be physically present in one place to be brought together. Besides traditional auctions, there are many varieties, e.g., a reverse or bidding auction;
- **e-mall** (online shopping centre) – a variety of a horizontal online shop. It brings together many online shops (independent) connected with a uniform method of payment or supply of goods;
- **e-business storefront** (online trade portal) – offers a full range of services indispensable to conduct online commercial transactions, starting with negotiating up to the final delivery. Such services facilitate business transactions to the sellers. They are either independent business establishments or are developed as a form of collaboration of firms from a particular industry;

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<sup>4</sup> Online shopping centres. A selection of e-shops usually operating under the same logo and offering services to well-known clients. E-malls offer added value, consisting in payment methods guaranteed and universally approved by clients, which increase customer trust to online purchases. On top of that, they open up the possibility to be a part of a virtual community and presenting opinions on user discussion forums.



- **e-business enabler** (support to e-business undertakings) – a format where firms deliver their tools or competence to enable other online entities to execute business processes;
- **buyer aggregator model** – connects many independent buyers with a view to saving money. Usually the option is available only to wholesalers, who buy products and services in large quantities, however, due to the purchasing power resulting from the scale of transactions, even small clients may negotiate higher discounts;
- **e-procurement** (online purchases) – online purchases of goods and services by businesses. It is a uniform IT system that functionally covers the entire process of purchasing: from requisition, through offer inquiry, authorisation, order, delivery, up to inspection upon delivery and payment to the supplier. Offers are submitted online. Such a solution offers an opportunity to find new suppliers and additional supply channels;
- **value-chain service provider** – where a firm offers special services from the value chain, such as: R&D works, logistics, post-warranty services or online payments. The goal is to create value for the buyer, which will exceed the costs incurred;
- **collaboration platform** – cooperation among firms which supply IT tools and environment to one another. In most cases it is managed by an independent entity and rented to other businesses. Such a platform enables relatively easy entry onto the e-business market without a company needing to build its own IT solutions;
- **information brokerage** – a firm offers services in collecting and delivering information (data). The broker acts as an intermediary between information resources and the people and organisations who need the information;
- **application service provider** (making apps available over the Internet) – a firm offers software available on the Internet and collects fees for its use;
- **virtual community** – created by groups of entities focused on a particular subject or market sector. By adding and exchanging information among group members they create added value, which may

be used in Public Relations activities. A virtual community enables interactions among Internet users, who may publish or comment on the content, thus blurring the border between originators and recipients of messages;

- **advertising model** – consists in making advertising content available to attract new clients. Charges are collected from entities interested in publishing their ads on the portal. Attracting and maintaining loyal readers of such a service, who, by browsing the websites, make ads appear on the screen, and the regular delivery of information that attracts users are big challenges to owners of such a business. This e-business model is the best for portals with large numbers of visitors or a narrow specialisation;
- **affiliate model** – consists in publishing links (ads) to related websites of different e-commerce firms. Charges for such banner ads are collected when a client clicks through the ad from an affiliate and makes a purchase with a particular firm to whom the link belongs. This format includes, e.g., shopping passages with well-developed loyalty schemes;
- **general portal** – an information service expanded with various on-line functionalities available from one website. Usually a portal contains information interesting to a wide audience (e.g., news) and mechanisms of browsing for information in its own or external on-line resources. In most cases it offers additional online functions (e.g., free electronic mail);
- **vortal** – an online service that delivers information in one particular field. It may focus on economy, finance, culture, films, etc.;
- **personalised portal** – an online service that requires prior registration. By analysing a user's behaviour and habits, the software underpinning the website personalises the content addressed to this person.

These examples of e-business models are not an exhaustive presentation of all possible forms of activity available to enterprises on the Web. Many of them evolve and new ones appear due to changes in technology. Many firms operate as two-side platforms and create a common meeting place where different groups of clients get in touch and interact. Others

increasingly often apply the *cloud computing*<sup>5</sup> model, which has changed organisational philosophy and its physical borders or use social networks and the idea of the so called e-society to achieve their objectives. Due to their complexity, contemporary e-business models necessitate ICT technologies that support them, i.e., CRM, tools to make business processes automatic or technologies that can secure Internet transactions. However, in the age of globalisation and continuous changes in the market, fundamental features remain unchanged: innovation, flexibility, openness and generating stakeholder value.

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Under the conditions of the modern economy, increasingly more firms treat ICTs, and the Internet in particular, as a working environment. This is especially true of online businesses, which apply ICTs in all relevant business areas, e.g.: finance, commerce, organisation, logistics, marketing, and advertising. The possibilities offered by e-business are powerful tools in the hands of contemporary entrepreneurs. A good idea may become the source of spectacular success as proven by the cases of, e.g., Amazon, Google, Facebook, YouTube or Allegro. Enterprises that want to be recognised must be present on the Internet, in particular when, to many customers, firms absent from the Web do not exist at all.

The network-based economy has also changed market relationships, which can be observed in the shifting of the “centre of gravity of power” from sellers towards buyers (Sagan 2013). That is due to rapid communication and easier access to information, as asymmetry in this respect has been significantly reduced. The Web-based economy developed new business models characterised with: 1). high flexibility accompanied by continuous improvement of operations using digital technologies, and 2). dynamism, meaning the risk of emergence of new participants and competitors in the market. Thus, the competitiveness of an enterprise in the modern world depends not only on physical resources but,

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<sup>5</sup> NIST (*National Institute of Standards and Technology*) defines *cloud computing* model as a “model for enabling network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications and services) that can be rapidly provisioned and released with minimal management of implementing teams in organisations, including service providers” (NIST 2015). In other words, it enables the use of IT resources available outside of the physical location, hence we may call it a new form of IT outsourcing in an organisation. It covers mainly dynamic access to hardware infrastructure, platforms and software via the Internet as well as infrastructure management by service providers in the “cloud”.

primarily, on knowledge, innovation, human resources or flexible organisational structures.

Online trade in goods and services is one of the most popular e-business models. For more than a decade we have been observing the dynamic development of e-commerce across the globe and in particular in Poland and in the European Union Member States. It demonstrates the huge potential of this area of the economy and its increasing relevance. To many large companies, getting involved in e-commerce is a must if they wish to maintain their market position, while to small ones it may become an opportunity to grow. According to eMarketer, an increase in the global B2C (business-to-consumer) e-commerce market is expected to reach 17.4% annually over the period 2014–2017 ([www.emarketer.com](http://www.emarketer.com), 2015). We may thus suppose that to be successful a business must go online. Opportunities offered by ICTs are great and they should be exploited much more intensely.

### Questions and assignments

1. Identify the major features of the “new” economy”.
2. Explain the importance of information and communication technologies to e-business.
3. Identify the differences between traditional and online trade.
4. Describe the selected e-business models.
5. Name the companies successful in e-business. Explain the success factors of a selected enterprise.

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