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BARTER: A SMALL BUSINESS STRATEGIC OPTION IN A WEAK ECONOMY

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ABSTRACT

This article probes the currently growing phenomenon of barter as a small business strategic tool. First, the concept of a barter exchange is explained, and the mechanics of small business membership in such exchanges are described. This is followed by a review of the literature, which indicates minimal academic analysis of this phenomenon. The research methodology of this study, involving a two-stage series of in-depth telephone interviews with owners, managers and small business members of barter exchanges, is then described. The research findings are then presented and are used to generate a set of specific guidelines for the small business owner/manager considering membership in a barter exchange. These guidelines answer the questions: "Will barter be applicable and beneficial for my company?" "How should I choose a barter exchange?" "How can I fully benefit from barter exchange membership?"

INTRODUCTION

Humans have always engaged in barter, and the first prehistoric "small businesses" certainly existed before the invention of money. Yet the past few years have seen a significant rise in the use of barter by businesses in this country and in others. Specifically in response to the currently weak economy, many businesses (and primarily small businesses) have implemented the use of barter as a strategic tool.

Information on the growth and extent of barter in our economy varies by source, but the general consensus is that somewhere between 200,000 and 400,000 small business firms have joined about 400 to 500 barter exchanges throughout the United States. While growth of these exchanges averaged about 8 percent per year in the 1980's, it has increased to about 12 percent per year in 1990-1991. The total retail value of these barter transactions in 1991 was about $6 billion (Kleiman, 1992; Nordheimer, 1992).

Simply stated, a small business that belongs to a barter exchange is able to trade its goods and services with all of the other members of the exchange-- typically several hundred businesses. The exchange acts as a clearinghouse and "bank" of barter debits and credits, and thus obviates the need for one-to-one barter. For example, Member A can barter goods to Member B and then obtain services from Member C at some future date, without any obligation to take goods from Member B.

The barter exchange typically charges an entry fee to new members, as well as an annual membership fee. Also, the exchange collects a commission (typically 5 percent to 10 percent) on each transaction, paid by the buyer and/or the seller.

In return for these various charges, the barter exchange does more than simply act as a clearinghouse. It will work to develop a broad mix of members with a minimal duplication of specific types of businesses. Directories of members are regularly published, as are newsletters and other publicity mailings to keep members informed of available goods and services and to encourage them to barter. Exchanges also monitor members' prices and other practices to assure fair and ethical conduct. Many businesses belong to more than one exchange, and most members use their trade credits to buy not only goods and services for their businesses, but also for their personal and families' use.

Barter sales are conducted at full retail prices. For tax purposes, a barter sale is a taxable sale. Sales tax must be collected if appropriate and the sale must be reported with all other sales.

The primary benefit of barter exchange membership to the member firm is the potential to increase sales volume. This has the direct effect of greater inventory turnover. The other major benefit is the ability to obtain goods and services for the business and the owner without paying cash, and this reduces the pressure on cash flow. For the typical business with both fixed and variable costs, barter sales reduce fixed costs per unit and can be considered validly profitable to the firm. Barter exchanges also contend that barter sales lead to greater awareness of the business, and thus in turn lead to more cash sales. As the currently weak economy has had a negative impact upon many small businesses' sales volumes and cash flows, these benefits of barter have increased in their attractiveness, and more small businesses have joined barter exchanges.

REVIEW OF THE LITERATURE

Many articles have been written about this phenomenon in the past few years, primarily in practitioner-oriented business magazines and in the business sections of newspapers (Applegate, 1990; Cohn & Kaufman, 1991; Healey, 1991; Nash, 1991; Selz, 1990; Stevens, 1992; Sympson, 1992; Williams, 1992). These articles are largely similar in content and provide a summary overview of the recent growth of barter exchanges and membership and the mechanics of how they work. Usually a few highly satisfied businessperson members are profiled. However, a search of the literature shows no academic business journal coverage of this topic, and no scholarly empirical research having been conducted.

RESEARCH OBJECTIVE

In response to this lack of empirical research and academic-level analysis of barter exchange membership, a research study was conducted. The objective was to develop a listing of specific guidelines for small business owners contemplating membership in barter exchanges (or for those who simply wish to know more about such exchanges). Furthermore, these guidelines would be of equal value to consultants who advise small business clients.

RESEARCH METHODOLOGY

A review of the existing literature, as discussed above, was first conducted. It was determined that an in-depth, unstructured, probing of both owners and members of barter exchanges would best elicit the information needed to achieve the research objective of developing a set of barter guidelines. Thus, it was concluded that a telephone survey methodology would be more appropriate than a mail survey.

Five barter exchanges, spread across the United States, were identified, and their owners and/or managers were interviewed at length by telephone. The objective at this stage was to obtain ideas about guidelines from the exchange's perspective, and also to obtain exchange membership lists.

These interviews were then followed by similar telephone interviews with five geographically distributed barter exchange members, ie. small business owners, chosen randomly from the various membership lists. Here, too, the objective was to obtain further ideas to help develop guidelines.

These first stage interviews led to a semi-structured interview format for the second stage of the research, which consisted of 15 additional telephone interviews with a random variety of small business owner members of these barter exchanges. Specifically, 10 questions were asked (see Table 1), giving the respondent ample opportunity to elaborate upon his or her answers. Interviews lasted from 10 to 20 minutes, and virtually all respondents were very cooperative and very willing to speak openly and fully. Furthermore, the respondents' comments, opinions, and attitudes proved to be highly consistent; most of the small business owners interviewed had very similar thoughts about their barter exchange membership and their recommendations to others contemplating such membership. Thus, additional interviews seemed unwarranted.

Table 1

Telephone Survey Questions (Open-Ended)

1. Is your membership in the barter exchange worthwhile?
2. What are the best aspects of membership?
3. What are the worst aspects?
4. Are the entry fee and annual fees worth it?
5. Is there a good variety of goods and services available?
6. Do you barter for personal use as well as business use?
7. Do you barter too much?
8. Why did you join the exchange?
9. If the economy improves, will barter seem as worthwhile?
10. What suggestions can you provide for small business owners who are considering joining a barter exchange?

RESEARCH FINDINGS

As the interviews progressed, it became apparent that the responses could be used to generate a valuable set of guidelines for the small business owner. These guidelines can be structured for three stages of advice to the small business owner: Will barter be applicable and beneficial for your company? How should a barter exchange be chosen? How can you fully benefit from barter exchange membership? These guidelines are summarized in Table 2.

Table 2

Guidelines for Barter Exchange Membership

Will Barter be Applicable and Beneficial for Your Firm?

- Unsold service time or products must be available.
- Gross margin percentage should be sufficiently high.
- Firm's products or services should have a broad market.
- Membership is more valuable to firms where cash flow is critical and/or where there is a need for fast inventory turnover.

How Should a Barter Exchange be Chosen?

- Choice may only exist in larger cities.
- Investigate each exchange fully.
- Talk to exchanges' managers and staff, not just salespeople.
- Talk to a sample of current members.
- Obtain membership directories to determine size and variety of members.
- Determine exchanges' other services (member assistance, networking, etc.).
- How long has the exchange existed?
- Does it belong to national exchange organizations?
- What are the various fees, charges, rules and regulations?

How Can You Fully Benefit from Barter Exchange Membership?

- Exercise conservatism and control!
- Start slowly and carefully.
- Don't let barter sales interfere with regular sales.
- Only barter-sell in-stock items.
- Only barter-sell at full retail prices.
- Keep barter-sales moderate until your barter-purchase needs level becomes clear.
- Control your urge to barter-purchase more than you truly need.
- Decide whether to barter-purchase for personal as well as business needs.

Some small businesses can benefit more from barter exchange membership than can others. A service firm will benefit if there is unsold service time available. Extra service time (ie. owner or employee hours) that is not being sold for cash can thus be used to create barter or "trade" credits. For a business selling products rather than services, the critical issue becomes gross margin. There must be sufficient spread between the cost of the product and the retail price. The greater this spread, the more valuable the trade credits become. Of course, there should be no limits or constraints on the availability of service time or of products, since it is not beneficial for barter sales to conflict with or limit cash sales in any way.

Issues of supply and demand should also be considered. If a company's product or service has very limited or specialized demand (glass eyes or nuclear reactor repair), then exchange membership will have little value. A company's product or service should be useable by a good portion of the exchange's members. Ideally, the demand for a company's barter sales should approximately equal the owner's demand for other exchange members' products and services.

The degree of importance of a company's cash flow and inventory turnover are also major issues. Barter exchange membership can be more valuable to a company with cash flow problems than to a company without such problems. Barter credits may allow a cash-starved firm to obtain needed supplies that it could not otherwise obtain. Similarly, barter sales add an extra benefit for the company that needs to turn its inventory more frequently (if its products become dated or stale, etc.). Conversely, barter sales are less valuable for a firm with a stable, non-aging product and rising supplier costs. Of course, barter can still be of value to an owner whose business has strong cash and inventory positions.

Once a small business owner determines that barter exchange membership <u>would</u> be of benefit, the issue becomes <u>which</u> exchange to join. In smaller cities only one exchange may exist, but in most localities a choice can be made.

The business owner should investigate the alternative exchanges carefully. The goal is to join an exchange that serves its members well. The business owner should talk to the exchange's managers and staff, and not simply to the person selling exchange membership. A good exchange will provide a sampling of current members who can then be spoken to. One should also obtain current directories to determine the number, variety and geographic location of the members. There should be a good mix of useful goods and services available through the exchange. A good exchange should also provide a wide variety of assistance to members, such as help when looking for specific needs. Does the exchange send out frequent newsletters and other mailings, does it have membership meetings and activities, and are exchange staff members available to help members when they ask?

Other measures of an exchange's quality are its longevity and its membership in such national organizations as the International Reciprocal Trade Association and the National Association of Trade Exchanges. Such membership tends to foster higher ethics and greater services on the part of the exchange. Of course, the business owner should also determine the various fees, charges, rules and regulations of the exchange being considered.

After a small business owner chooses a barter exchange and joins it, the guidelines center on <u>conservatism</u> and <u>control</u>. Although the exchange will encourage the member to sell and buy (that is how it generates an income), a new member should start slowly and carefully. Barter sales should be kept under control so that they do not interfere with cash sales nor become too great a percentage of total sales. Generally, only in-stock items should be sold and only at full retail prices--never at discount or at sale prices. A new member's trade balance should be kept moderate until the member has a clear feeling for his or her barter purchase needs and expected levels. Exchange rules vary, but most exchanges allow members to limit or refuse barter sales when they wish to and this option should be used as needed.

Similarly, barter purchases should be kept under control. Because cash is not being used, it is easy to get carried away (as it is in Las Vegas using tokens or chips instead of "real" money). The exchange member should set quantitative and qualitative purchase limits and guidelines. Should trade credits be used for personal, non-business purchases? Would the owner spend cash on this product or service? Is it really needed? Perhaps a monthly budget would be of value. The on-going question is: What was the true cost of the trade credits earned by barter sales and is this barter purchase worth that cost?

CONCLUSIONS

Barter as a small business strategic tool is a growing and significant phenomenon in our economy, and small business owners should consider this option as part of their total strategy package. Such a strategy can serve to offset some of the negative impact of a weak economy-especially the impact on sales volume, inventory turnover, and cash flow. This article has presented a series of guidelines that can assist the small business owner in determining whether his or her firm will benefit from barter exchange membership, in choosing an exchange to join, and in making the most out of exchange membership.

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