Unit IB11: International Business
Part 1

Name: ____________________

Date: __/__/__

Meaning

Manufacturing and trade beyond the boundaries of one's own country is known as international business. International or external business can, therefore, be defined as those business activities that take place across the national frontiers. It involves not only the international movements of goods and services, but also of capital, personnel, technology and intellectual property like patents, trademarks, knowledge, and copyrights

Reasons for International Business

The fundamental reason behind international business is that the countries cannot produce equally well or cheaply all that they need. This is because of the unequal distribution of natural resources among them or differences in their productivity levels.

Availability of various factors of production such as labour, capital and raw materials that are required for producing different goods and services differ among nations. Moreover, labour productivity and production costs differ among nations due to various socio-economic, geographical, and political reasons.

Due to these differences, it is common to find one particular country being in a better position to produce better quality products and/ or at lower costs than what other nations can do.

Difference between Internal and International Business

International Business	Domestic Business
It is extension of Domestic Business and Marketing Principles remain same.	The Domestic Business Follow the marketing Principles
Difference is customs, cultural factors	No such difference. In large countries like India, we have many languages.
Conduct and selling procedure changes	Selling Procedures remain unaltered
Working environment and management practices change to suit local conditions.	No such changes are necessary
Must face restrictions in trade practices, licenses, and government rules.	These have little or no impact on Domestic trade.
Long Distances and hence more transaction time.	Short Distances, quick business is possible.
Currency, interest rates, taxation, inflation, and economy have impact on trade.	Currency, interest rates, taxation, inflation, and economy have little or no impact on Domestic Trade.
MNC's have perfected principles, procedures, and practices at international level	No such experience or exposure.
MNCs take advantage of location economies wherever cheaper resources available.	No such advantage once plant is built it cannot be easily shifted.
Large companies enjoy benefits of experience curve	It is possible to get this benefit through collaborators.
High Volume cost advantage.	Cost Advantage by automation, new methods etc.

Scope of International Business

(i) <u>Merchandise exports and imports:</u> Merchandise means goods that are tangible, i.e., those that can be seen and touched. When viewed from this perceptive, while merchandise exports mean sending tangible goods abroad, merchandise imports mean bringing tangible goods from a foreign country to one's own country.

(ii) <u>Service exports and imports:</u> Service exports and imports involve trade in intangibles. It is because of the intangible aspect of services that trade in services is also known as invisible trade. A wide variety of services are traded internationally. these include: tourism and travel, boarding and lodging (hotel and restaurants), entertainment and recreation, transportation, professional services (such as training, recruitment, consultancy, and research), communication, construction and engineering, marketing (e.g., wholesaling, retailing, advertising, marketing research and warehousing), educational and financial services (such as banking and insurance). Of these, tourism, transportation, and business services are major constituents of world trade in services

(iii) <u>Licensing and franchising:</u> Permitting another party in a foreign country to produce and sell goods under your trademarks, patents or copy rights in lieu of some fee is another way of entering international business.

(iv) <u>Foreign investments:</u> Foreign investment is another important form of international business. Foreign investment involves investments of funds abroad in exchange for financial return. Foreign investment can be of two types: direct and portfolio investments.

International Business vs International Trade

It may be mentioned here that mostly people think of international business as international trade. But this is not true. No doubt international trade, comprising exports and imports of goods, has historically been an important component of international business.

But of late, the scope of international business has substantially expanded. International trade in services such as international travel and tourism, transportation, communication, banking, warehousing, distribution, and advertising has considerably grown. The other equally important developments are increased foreign investments and overseas production of goods and services.

Companies have started increasingly making investments into foreign countries and undertaking production of goods and services in foreign countries to come closer to foreign customers and serve them more effectively at lower costs. All these activities form part of international business.

Benefits of International Business

Benefits to Countries

(i) Earning of foreign exchange: International business helps a country to earn foreign exchange which it can later use for meeting its imports of capital goods, technology, petroleum products and fertilisers, pharmaceutical products and a host of other consumer products which otherwise might not be available domestically.

(ii) More efficient use of resources: As stated earlier, international business operates on a simple principle — produce what your country can produce more efficiently, and trade the surplus production so generated with other countries to procure what they can produce more efficiently.

(iii) Improving growth prospects and employment potentials: Many countries, especially the developing ones, could not execute their plans to produce on a larger scale, and thus create employment for people because their domestic market was not large enough to absorb all that extra production.

(iv) Increased standard of living: In the absence of international trade of goods and services, it would not have been possible for the world community to consume goods and services produced in other countries that the people in these countries are able to consume and enjoy a higher standard of living.

Benefits to Firms

(i) Prospects for higher profits: International business can be more profitable than the domestic business. When the domestic prices are lower, business firms can earn more profits by selling their products in countries where prices are high.

(ii) Increased capacity utilisation: Many firms' setup production capacities for their products which are more than demand in the domestic market. By planning overseas expansion and procuring orders from foreign customers, they can think of making use of their surplus production capacities and improving the profitability of their operations.

(iii) Prospects for growth: Business firms find it quite frustrating when demand for their products starts getting saturated in the domestic market. Such firms can considerably improve prospects of their growth by plunging into overseas markets.

(iv) Way out to intense competition in domestic market: When competition in the domestic market is very intense, internationalisation seems to be the only way to achieve significant growth.

(v) Improved business vision: The growth of international business of many companies is essentially a part of their business policies or strategic management.

India’s Involvement in World Trade

- India is now the 10th largest economy in the world and the fastest growing economy, next only to China. As per the Goldman Sachs Report 2004, India is poised to be the second largest economy by 2050.
- India accounts for a small share in world trade, its exports and imports constitute major economic activities for the country. Due to faster growth achieved at the external front, share of foreign trade in the country’s Gross Domestic Product (GDP) has considerably increased from 14.6 per cent in 1990-91 to 24.1 per cent in 2003-04.
- India’s total merchandise exports were engineering products and chemicals and related products and agricultural and allied products are India’s major items of India’s exports.
- So far as imports are concerned, products likes crude oil and petroleum products, capital goods (i.e., machinery), electronic goods, pearl, precious and semi-precious stones, gold, silver and chemicals constitute major items of India’s imports
- What is more remarkable is the change in the composition of services exports. Software and other miscellaneous services (including professional technical and business services) have emerged as the main categories of India’s exports of services
- There has been a phenomenal increase in foreign investments flow into and from India. While the inward foreign investments have grown more than 750 times from just Rs. 201 crores in 1990-91 to Rs. 1,51,406 crores in 2003-04, India’s investments abroad have increased much more exponentially — around 4,927 times— from Rs. 19 crores in 1990-91 to Rs. 8,3,616 crores in 2003-04.

Export and Import Method

Meaning

Exporting refers to sending of goods and services from the home country to a foreign country. In a similar vein, importing is purchase of foreign products and bringing them into one's home country. There are two important ways in which a firm can export or import products: direct and indirect exporting/importing

Advantages

(i) As compared to other modes of entry, exporting/importing is the easiest way of entering international markets.

(ii) Exporting/importing is less involving in the sense that business firms are not required to invest that much time and money as is needed when they desire to enter joint ventures or set up manufacturing plants and facilities in host countries.

(iii) Since exporting/importing does not require much of investment in foreign countries, exposure to foreign investment risks is zero.

Limitations

(i) Since the goods physically move from one country to another, exporting/importing involves additional packaging, transportation, and insurance costs.

(ii) Exporting is not a feasible option when import restrictions exist in a foreign country.

(iii) Export firms basically operate from their home country. They produce in the home country and then ship the goods to foreign countries.

Contract Manufacturing

Meaning

Contract manufacturing refers to a type of international business where a firm enters into a contract with one or a few local manufacturers in foreign countries to get certain components or goods produced as per its specifications.

Advantages

(i) Contract manufacturing permits the international firms to get the goods produced on a large scale without requiring investment in setting up production facilities.

(ii) Since there is no or little investment in the foreign countries, there is hardly any investment risk involved in the foreign countries.

(iii) Contract manufacturing also gives an advantage to the international company of getting products manufactured or assembled at lower costs especially if the local producers happen to be situated in countries which have lower material and labour costs.

(iv) Local producers in foreign countries also gain from contract manufacturing. If they have any idle production capacities, manufacturing jobs obtained on contract basis in a way provide a ready market for their products and ensure greater utilisation of their production capacities.

(v) The local manufacturer also gets the opportunity to get involved with international business and avail incentives, if any, available to the export firms in case the international firm desires goods so produced be delivered to its home country or to some other foreign countries.

Limitations

(i) Local firms might not adhere to production design and quality standards, thus causing serious product quality problems to the international firm.

(ii) Local manufacturer in the foreign country loses his control over the manufacturing process because goods are produced strictly as per the terms and specifications of the contract.

(iii) The local firm producing under contract manufacturing is not free to sell the contracted output as per its will. It must sell the goods to the international company at predetermined prices.

Licensing and Franchising

Meaning

Licensing is a contractual arrangement in which one firm grants access to its patents, trade secrets or technology to another firm in a foreign country for a fee called royalty. The firm that grants such permission to the other firm is known as licensor and the other firm in the foreign country that acquires such rights to use technology or patents is called the licensee.

Advantages

(i) Under the licensing/franchising system, it is the licensor/ franchiser who sets up the business unit and invests his/her own money in the business. Licensor/franchiser is paid by the licensee/franchisee by way of fees fixed in advance as a percentage of production or sales turnover.

(ii) Since the business in the foreign country is managed by the licensee/franchisee who is a local person, there are lower risks of business takeovers or government interventions.

(iii) Licensee/franchisee being a local person has greater market knowledge and contacts which can prove quite helpful to the licensor/franchiser in successfully conducting its marketing operations.

(iv) As per the terms of the licensing/ franchising agreement, only the parties to the licensing/franchising agreement are legally entitled to make use of the licensor's/ franchiser's copyrights, patents and brand names in foreign countries.

Disadvantages

(i) When a licensee/franchisee becomes skilled in the manufacture and marketing of the licensed/franchised products, there is a danger that the licensee can start marketing an identical product under a slightly different brand name.

(ii) If not maintained properly, trade secrets can get divulged to others in the foreign markets. Such lapses on the part of the licensee/ franchisee can cause severe losses to the licensor/franchiser.

(iii) Over time, conflicts often develop between the licensor/franchiser and licensee/franchisee over issues such as maintenance of accounts, payment of royalty and non-adherence to norms relating to production of quality products.

Joint Ventures

Meaning

Joint venture is a very common strategy for entering foreign markets. A joint venture means establishing a firm that is jointly owned by two or more otherwise independent firms. In the widest sense of the term, it can also be described as any form of association which implies collaboration for more than a transitory period.

Ways of Doing JV

A joint ownership venture may be brought about in three major ways:

(i) Foreign investor buying an interest in a local company
(ii) Local firm acquiring an interest in an existing foreign firm
(iii) (iii) Both the foreign and local entrepreneurs jointly forming a new enterprise.

Advantages

(i) Since the local partner also contributes to the equity capital of such a venture, the international firm finds it financially less burdensome to expand globally.
(ii) Joint ventures make it possible to execute large projects requiring huge capital outlays and manpower.
(iii) The foreign business firm benefits from a local partner's knowledge of the host countries regarding the competitive conditions, culture, language, political systems, and business systems.
(iv) In many cases entering a foreign market is very costly and risky. This can be avoided by sharing costs and/or risks with a local partner under joint venture agreements.

Disadvantages

(i) Foreign firms entering into joint ventures share the technology and trade secrets with local firms in foreign countries, thus always running the risks of such a technology and secrets being disclosed to others.
(ii) The dual ownership arrangement may lead to conflicts, resulting in battle for control between the investing firms.

Wholly Owned Subsidiaries

Meaning

This entry mode of international business is preferred by companies which want to exercise full control over their overseas operations. The parent company acquires full control over the foreign company by making 100 per cent investment in its equity capital.

Ways of Doing

(i) Setting up a new firm altogether to start operations in a foreign country — also referred to as a green field venture

(ii) Acquiring an established firm in the foreign country and using that firm to manufacture and/or promote its products in the host nation.

Advantages

(i) The parent firm can exercise full control over its operations in foreign countries.

(ii) Since the parent company on its own looks after the entire operations of foreign subsidiary, it is not required to disclose its technology or trade secrets to others.

Disadvantages

(i) The parent company must make 100 per cent equity investments in the foreign subsidiaries. This form of international business is, therefore, not suitable for small and medium size firms which do not have enough funds with them to invest abroad.

(ii) Since the parent company owns 100 per cent equity in the foreign company, it alone must bear the entire losses resulting from failure of its foreign operations.

(iii) Some countries are averse to setting up of 100 per cent wholly owned subsidiaries by foreigners in their countries. This form of international business operations, therefore, becomes subject to higher political risks.