Chapter- 10

INTERNATIONAL BUSINESS

MEANING OF INTERNATIONAL BUSINESS

With the advent of globalization , there is a shift on the part of all countries from self realize to increasing dependence on others for procuring and supplying various kinds of goods and services. The reasons behind this radical change decades is due to the following eight factors:

- Technology_ especially in transport and communication
- Government_ removing international restrictions
- Institutions_ services to ease the conduct of international business
- Consumers_ want to know about foreign goods and services
- Competitions_ become more global
- Political_ relationship improved among some major economic power
- Countries
- - more co-operation on transnational issues
- Cross national_ cross national cooperation and agreements

Meaning of international business

International business comprises all commercial transitions that take place between two or more regions, countries and nations beyond their political boundaries

Reasons for international business

- Diversity and unequal distribution of natural resources warrant such dependence.
- Abundant resources facilities large scale production of certain goods which are sent to other parts of world.
- Availability of various factors of production like labor, capital and raw materials which are required for the production of goods and services differ among countries
- To produce select goods and services in which they are best.

Importance of international business

- **It enable a country to concentrate on those goods for which its resources are best suited**
- **It leads to international specialization and division of labor**
- **It enables a country to dispose of surplus goods in exchange for scarce ones.**
- **It maintain price stability across the world**
- **It paves the way for better relations among nations**
- **It provide greater employment opportunities**
- **It earns foreign exchange**
- **It increases the standard of living of the people all over the world**

Distinction between domestic business and international business

Domestic business	International business
1) Exchange of goods between the individuals of the same nation.	Exchange goods between the individuals of different nations
2) Subject to regulations and laws of only one country	Subject to regulations and laws of different countries
3) Domestic business is generally free from restrictions	International business is subject to a number of restrictions like customs duties, exchange restrictions etc.,
4) The numbers of documents required is much less	The number of documents required is grater
5) There is much scope for the operation of the forces not demand and supply	There is not full scope for the operation of the forces of demand and supply
6) The cost of transport is much less	The cost of transport is grater
7) Insurance is not compulsory	Insurance is compulsory
8) Goods are subject to less risk	As goods have to be transported over a long distance across high seas, goods are subject to grater risks.

9) Accounts are settled in national currency	Accountings are settled in foreign currencies. it involves the conversion of currency of one country into the currency of another country though an exchange bank.
10) There are only limited formalities	There are many formalities
11) It is carried on as wholesales trade and retail trade	It is always carried on, on a wholesale basis.

Scope of international business

We have explained earlier that international business is a much wider term than international trade. Major areas of operations of international business are briefly discussed below:

- ✓ **Merchandise export and imports**

  Merchandise exports and imports involve tangible goods and exclude services

- ✓ **Service export and imports**

  By service export and imports we mean trade in intangible, i.e., those that cannot be seen or touched b. because of this intangible nature. Trade in services is also known as invisible trade.

- ✓ **Licensing and franchising**

  Permitting a person/ firm in a foreign country to produce and sell goods under your trademarks, patents or copyrights for a fee Is another way of operating international business.

- ✓ **Foreign investments**

  Foreign investment means investment abroad in exchange for financial return. Foreign investments can be- Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI).

  FDI takes place when a company invests in properties such as land, plant, machinery, etc.

FPI takes place when a company makes investment in a foreign company by way of acquiring shares or granting loans.

Benefits of international business

Benefits to nations

a. **Earning of foreign exchange: it earn foreign exchange which can be utilized to meet its imports of capital goods , technology, petroleum products and other consumer products**
b. **More efficient use of resources: each country can efficient use their resources to the benefit of all the trading nations**
c. **Improving growth prospects and employment potentials: production by a country not the purpose of domestic consumption at with an eye on international markets improves its own growth prospects and creates employment opportunities to people living in those countries with which trade is affected.**
d. **Increased standard of living: goods produced in different parts of the world are now available locally. People in every country are now in a position to consume world-class products and enjoy a higher standard of living.**

Benefits to firms

- **Higher profit: international business bring home the firms higher profits than the limited market domestic business**
- **Increased capacity utilization: surplus production capacity of domestic firms can be utilized by planning overseas expansion and procuring orders from foreign customers.**
- **Prospects for growth: there is always a limit to the domestic market and hence growth will be restricted. So firms can considerably improve prospects of their growth by capturing foreign markets.**
- **Way out to intense competition in domestic market: when completion in the domestic market is intense, cross –border trade is the only solution to achieve significant growth.**
- **Improved business vision: the vision to become international actually comes from their urge to grow the need to become competitive, the need to diversity and read the benefits of internationalization.**

Problems in international business

a. **Political factors**

b. **High foreign investment and high cost**

c. **Exchange instability**

d. **Entry requirements**

e. **Tariffs, quota, etc.,**

f. **Corruption and bureaucracy**

g. **Technological policy**

Modes of entry into international business

1. **Exporting and and importing**

Export refers to sending of goods and services for sale from the home country to foreign countries. Importing means purchasing of goods and services from foreign countries for domestic use. Export/import can be carried out directly or indirectly .in the case of direct method the exporter/ importer goes through all the procedures by him. Exporter/ importer make use of the services of middleman in the indirect method so that he can be relieved of the complexities of export/ import procedures.

Advantages

- **This is the easiest way of entering into international markets**
- **Exporting / importing does not necessitate investment abroad, exposure to foreign investment risks is practically nil.**

Disadvantages

- **Goods have to be physically moved from one country to another, additional costs for packaging, transportation and insurance are involved**
- **This is not a feasible method**
- **They may not have adequate knowledge about foreign markets**

2. **Contract manufacturing**

A company enters into a contract with a local manufacturer in a foreign country. The contract is for getting certain components or goods produced as per specification given. Contract manufacturing also called outsourcing can take the following three forms:

- **Production of certain components**
- **Assembly of components into final products**
- **Complete manufacture of the products**

Advantages

a. **Firms get goods produced on a large –scale without having investment in setting up of production facilities**

b. **No investment is required in such a foreign country, there is hardly any investment risk involved**

c. **Facilitates getting products with lower material and labour costs**

d. **Local manufacturers are in an advantageous position as they can utilize their idle production capacities.**

e. **Local manufacture get involved in international business, they can avail incentives**

Disadvantages

- **Local firms not adhering to quality standards, pose quality problems to the international firm.**
- **As local firms have to produce strictly as per the terms and specifications, they lose the freedom in the production process**
- **The goods are produced according to the terms of the contract; they cannot freely sell in the open market.**

3. **Licensing and franchising**

Licensing in international business is a contractual agreement in which one firm permits another firm in a foreign country to access its trademarks. Patents or technology for a fee

called royalty. The firm which gives permission is called licensor and to whom it is given is called licensee.

Franchising is somewhat similar to licensing. The difference is that , in the case of former it is concerned with production and marketing of goods while franchising is connected with provision of services. Franchising is relatively more stringent than licensing. The parent company is called the franchiser and the party to whom franchisee is granted is called the franchisee.

Advantages

- It is a less expensive mode for the licensor/ franchiser of entering into international business
- No or little investment is made by the licensor/ franchiser
- Limited risks of takeovers or government interventions
- He can have greater market knowledge and contacts.

Disadvantages

- Getting experienced with the production and marketing of franchised products, the licensee/franchisee can start on his own identical products with slight changes and in a different brand name
- There are chances of trade secrets being lost in the foreign markets. Such lapses on the part of licensee/ franchisee cause severe losses to the licensor/ franchiser
- Costly litigation, harmful to both the parties.

4. <u>Joint ventures</u>

This is a very common mode of entering into international business. Joint venture means starting a firm which is jointly owned by the two or more otherwise independent firms. A joint venture comes into in three major ays:

i. Foreign investors buying an interest in a local firm.
ii. Local firm acquiring an interest in an existing foreign firm
iii. Both the firms_ foreign and local_ jointly establishing a new firm.

Advantages

- ✓ It is less financial burden to the international firm
- ✓ With vast resources at their disposal, by forming joint venture , large projects required huge capital outlays can be undertaken
- ✓ Foreign firm benefits from a local partner's knowledge of the host countries with respect to matters such as competitive conditions, culture , language, and business systems
- ✓ Entering into foreign market is very costly and risky.

Disadvantages

- ✓ There are chances of trade secrets being lost
- ✓ The dual ownership arrangement may often lead to conflicts with the result that there will be battle for control in the investing firm.

5. <u>Wholly owned subsidiaries</u>

Those companies which want to exercise full control over their overseas operations prefer this mode. The holding company acquires 100%shares in the subsidiary company and thereby gets full control over it. A wholly owned subsidiary company can be established in a foreign market in either of the two ways:

- **i.** Set up a firm altogether to carry on overseas activities in a foreign country.
- **ii.** Acquire an existing firm in the foreign country

Advantages

- ➢ Full control over its operations in foreign countries
- ➢ No chance of technology being disclosed to others or trade secrets being lost.

Disadvantages

- As the parent company has to invest 100%equity capital, this mode of international business is not suitable for small and medium- size business.
- It invest cent percent capital, it alone has to bear the entire loss from its foreign operations.
- Some countries are averse to setting up of wholly owned subsidiaries by foreign companies in their countries .

<u>India's involvement in world business</u>

India is now the 10th largest economy in the world. India is the fastest growing economy. Next to china. By 2050, as per Goldman Sachs Report 2004, India is going to become the second largest economy. Despite these facts and figures, India's share in the international business is not that much encouraging.