

Chapter 1 – The Objectives, Importance and Scope of International Business

Meaning and Evolution of International Business:

International business is the process of focusing on the resources of the globe and objectives of organizations on the global business opportunities and threats, in order to produce, buy, sell or exchange goods/services world-wide. The concept of international business – broader concept relating to the integration of economies and societies – dates back to the 19th century beginning in 1870. This first phase of globalization ended with the World War-I (1919) driven by the industrial revolution in the United Kingdom (UK), Germany and the United States of America (USA). The import of raw materials by colonial empires from their colonies and exporting finished goods to their overseas possessions was the main reason for the sharp increase in the trade during this phase. The ratio of trade to Gross Domestic Product (GDP) was as high as 22.1 in 1913.

Later various governments initiated and imposed a number of barriers to trade to protect their domestic production that led to decline in the ratio of trade to GDP to 9.1 during the 1930s. Advanced countries experienced a severe setback consequent to the imposition of trade barriers as they produced in excess of domestic demand and a decline in the volume of international trade. Added to this, the breakdown of the gold standard resulted in a vacuum in the field of international trade. The world nations felt the need for international co-operation in global trade and balance of payment affairs. These efforts resulted in the establishment of International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD-popularly known as the World Bank).

The prolonged recession before the World War II in the West, led to an international consensus after the World War II that a different approach towards international trade was required. Consequently, 23 countries conducted negotiations in 1947 in order to prevent the protectionist policies and to revive the economies from recession aiming at the establishment of an international trade organization. This attempt of the advanced countries ended with the General Agreement on Trade and Tariffs (GATT) that provided a framework for a series of ‘rounds’ of negotiations by which tariffs were reduced. Efforts to convert the GATT into the World Trade Organization (WTO) were intensified during 1980s and ultimately GATT was replaced by the WTO on 1st January 1995, envisaging trade liberalization. The efforts of IMF, World Bank and WTO along with the efforts of individual countries due to economic limitations of the closed economies led to the globalization of business. Globalization has given a fillip to international business particular during the 1990s.

Objectives or Goals of International Business:

1. To Achieve Higher Rate of Profits:

The basic objective of business is to achieve profits. When the domestic markets do not promise a higher rate of profits, business firms search for foreign markets that hold promise for higher rate of profits. Thus the objective of profit affects and motivates the business to expand operations to foreign countries. For example, Hewlett Packard in the USA earned 86.2% of its profits from the foreign markets compared to that of domestic markets in 2007. Apple earned US \$ 730 million as net profit from the foreign markets and only US \$ 620 million as net profit from its domestic market in 2007.

2. Expanding the Production Capacities beyond the Demand of the Domestic Country:

Some of the domestic companies expand their production capacities more than the demand for the product in domestic countries. These companies, in such cases, are forced to sell their excess production in foreign developed countries. Toyota of Japan is an example.

3. Severe Competition in Home Country:

The countries oriented towards market economies since 1960s experienced severe competition from other business firms in the home countries. The weak companies which could not meet the competition of the strong companies in the domestic country started entering the markets of the developing countries.

4. Limited Home Market:

When the size of the home market is limited either due to the smaller size of the population or due to lower purchasing power of the people or both, the companies internationalize their operations. For example, most of the Japanese automobiles and electronic firms entered the USA, Europe and even African markets due to smaller size of the home market. Similarly, the mere six million population of Switzerland is the reason for Ciba-Geigy to internationalize its operations. ITC entered the European market due to the lower purchasing power of the Indians with regard to high quality cigarettes.

5. Political Stability vs. Political Instability:

Political stability does not simply mean that continuation of the same party in power, but it does mean that continuation of the same policies of the Government for a quite longer period. It is viewed that the USA is a politically stable country; countries like the UK, France, Germany, Italy and Japan are also politically stable. Most of the African countries and some of the Asian countries are politically instable countries. Business firms prefer to enter politically stable countries and are restrained from locating their business operations in politically instable countries. In fact, business firms shift their operations from politically instable countries to politically stable countries.

6. Availability of Technology and Competent Human Resources:

Availability of advanced technology and competent human resources in some countries act as pulling factors for business firms from the home country. The developed countries due to these reasons attract companies from the developing world. In fact, American and European companies, in recent years, depended on Indian companies for software products and services through their business process outsourcing (BPO). India's software and service exports crossed US \$ 23.4 billion in 2006 and it targets to cross US \$ 60 billion by 2010. This is because the cost of professionals in India is 10 to 15 times less compared to the US and European labour markets.

7. High Cost of Transportation:

Initially companies enter foreign countries their marketing operations. The home companies in any country enjoy higher profit margins as compared to the foreign firms on account of the cost of transportation of the products. Under such conditions, the foreign companies are inclined to increase their profit margin by locating their manufacturing facilities in foreign countries through the Foreign Direct Investment (FDI) route to satisfy the demand of either one country or a group of neighbouring countries. For example, Mobil which was supplying petroleum products to Ethiopia, Kenya, Eritrea, Sudan etc., from its refineries in Saudi Arabia, established its refinery facilities in Eritrea in order to reduce the cost of transportation.

8. Nearness to Raw Materials:

The source of highly qualitative raw materials and bulk raw materials is a major factor for attracting the companies from various foreign countries. For example Vedanta Resources is a London Stock Exchange (LSE) listed UK based company operating principally in India due to availability of raw materials such as iron ore, copper, zinc and lead. It also has substantial operations in Zambia and Australia where ample copper is available.

9. Liberalisation and Globalisation:

Most of the countries in the globe liberalized their economies and opened their countries to the rest of the globe. These change in policies attracted multinational companies to extend their operations to these countries.

10. To Increase Market Share:

Some of the large-scale business firms would like to enhance their market share in the global market by expanding and intensifying their operations in various foreign countries. Companies that expand internally tend to be 'oligoplistic'.

Smaller companies expand internationally for survival while the larger companies expand to increase their market share. For example Ball Corporation, the third largest beverage can manufacturer in the USA, bought the European packaging operations of Continental Can Company. Then it expanded its operations to Europe and met the Europe demand which is 200 per cent more than that of the USA. Thus, it increased its global market share of soft drink cans.

11. Tariffs and Import Quotas:

It was quite common before globalization that governments imposed tariffs or duty on imports to protect the domestic company. Sometimes government also fixes import quotas in order to reduce the competition to the domestic companies from the competent foreign companies. These practices are prevalent not only in developing countries but also in advanced countries. For example Japanese companies are tough competitors to the US companies, USA imposed tariffs and quotas for import of automobiles and electronics from Japan. Similarly Japan also places high tariffs on imports of rice and other agricultural goods from the USA. To avoid high tariffs and quotas, companies prefer foreign direct investment (FDI) to go global. For example companies like Sony, Honda and Toyota preferred direct investment in various countries by establishing subsidiaries or through joint ventures in various foreign countries including the USA and India.

Importance and Advantages of International Business:

1. High Living Standards:

Comparative cost theory indicates that the countries which have the advantages of raw materials, human resources, natural resources and climatic conditions in producing particular goods can produce the products at low cost and also of high quality. Customers in various countries can buy more products with the same amount of money. In turn, it can also enhance the living standards of the people through enhanced purchasing power and by consuming high quality products.

2. Increased Socio-Economic Welfare:

International business enhances consumption level, and economic welfare of the people of the trading countries. For example the people of China are now enjoying a variety of products of various countries than before as China has been actively involved in international business like Coca-Cola, McDonald's range of products, electronic products of Japan and coffee from Brazil. Thus the Chinese consumption levels and socio-economic welfare has enhanced.

3. Wider Market:

International business widens the market and increases the market size. Therefore, the companies need not depend on the demand for the product in a single country

or customer's tastes and preferences of a single country. Due to the enhanced market Air France, now, mostly depends on the demand for air travel of the customers from countries other than France. This is true in case of most of the MNCs like Toyota, Honda, Xerox and Coca-Cola.

4. Reduced Effects of Business Cycles:

The stages of business cycles vary from country to country. Therefore, MNCs shift from the country experiencing a recession to the country experiencing 'boom' conditions. This enables international firms to escape recessionary conditions.

5. Reduced Risks:

Both commercial and political risks are reduced for the companies engaged in international business due to spread in different countries. Multinationals which were operating in erstwhile USSR were affected only partly due to their safer operations in other countries. But the domestic companies of the then USSR collapsed completely.

6. Large-scale Economies:

Multinational companies due to wider and larger markets produce larger quantities, which provide the benefits of large-scale economies like reduced cost of production, availability of expertise, quality etc.

7. Potential Untapped Markets:

International business provides the chance of exploring and exploiting the potential markets which are untapped so far. These markets provide the opportunity of selling the product at a higher price than in domestic markets. For example Bata sells shoes in the UK at £ 100 (Around Rs. 8000) whose price is around Rs. 1200 in India.

8. Provides the Opportunity for and Challenge to Domestic Business:

International Business firms provide opportunities to the domestic companies. These opportunities include technology, management expertise, market intelligence, product developments etc. For example Japanese firms like Honda, Yamaha, Suzuki and Kawasaki have combined to form Joint Ventures with Indian companies to form Hero Honda, Birla Yamaha, Maruti Suzuki and Kawasaki Bajaj to share technology and product development expertise. Similarly MNCs pose challenges to domestic business initially. Domestic firms develop themselves to meet these challenges. For example the entry of whitegoods MNCs LG and Samsung posed challenges to homegrown companies Godrej and Videocon in the

Indian consumer durables market. But Godrej and Videocon have evolved and reinvented themselves to face up to the challenges.

9. Division of Labour and Specialisation:

International business leads to division of labour and specialization. For example Brazil specializes in coffee, Kenya in tea, Japan in automobiles and electronics, India in textile garments etc.

10. Economic Growth of the World at large:

Specialization, division of labour, enhancement of productivity, posing challenges, development to meet them, innovations and creations to meet the competition lead to overall economic growth of the world nations. International business particularly helped the Asian countries like Japan, Taiwan, Korea, Philippines, Singapore, Malaysia and the United Arab Emirates.

11. Optimum and Proper Utilisation of World Resources:

International business provides for the flow of raw materials, natural resources and human resources from the countries where they are in excess supply to those countries where they are in short supply or need most. For example flow of human resources from India, consumer goods from the UK, France, Italy and Germany to developing countries. This, in turn, helps in the optimum and proper utilization of world resources.

12. Cultural Transformation:

International business benefits are not purely economical or commercial, they are even social and cultural. These days, we observe that the West is slowly tending towards the East and vice-versa. It does mean that the good cultural factors and values of the East are acquired by the West and vice-versa. Thus there is a close cultural transformation and integration.

13. Knitting the World into a Closely Interactive Traditional Village:

International business ultimately knits the global economies, societies and countries into a closely interactive traditional village where one is for all and all are for one.

Scope of International Business:

The term international business was not popular two decades earlier. The term international business has emerged from the term 'international marketing', which in turn emerged from the term 'international trade'.

International Trade to International Marketing: Originally, the producers used to export their products to the nearby countries and gradually extended the exports to far-off countries. Gradually, the companies extended the operations beyond trade. For example, India used to export raw cotton, raw jute and iron ore during the early 1900s. The massive industrialization in the country enabled India to export steel, jute products and cotton garments during 1960s.

India, during 1980s could create markets for its products, in addition to mere exporting through export marketing efforts to generate demand for Indian products like textiles, electronics, leather products, tea, coffee etc. This process is true not only with India, but also with almost all developed and developing economies of the world.

International Marketing to International Business: The multinational companies which were producing the products in their home countries and marketing them in various foreign countries before 1980s, started locating their plants and other manufacturing facilities in foreign/host countries. Later, they started producing in one foreign country and marketing in other foreign countries. For example Uni Lever established its subsidiary company in India, i.e., Hindustan Lever Limited (HLL). HLL produces its products in India and markets them in Bangladesh, Sri Lanka, Nepal etc. Thus, the scope of international trade is expanded into international marketing and international marketing is expanded into international business.

Wide Scope: The scope of international business is much broader involving international marketing, international investments, management of foreign exchange, procuring international finance from IMF, IBRD, International Finance Corporation (IFC), International Development Association (IDA) etc., management of international human resources, management of cultural diversity, management of international production and logistics, international strategic management and the like.

Inter-country Comparative Study: International business studies the business opportunities, threats, consumer's preferences, behaviour, cultures of the societies, employees, business environmental factors, manufacturing locations, management styles, inputs and human resource management practices in various countries. International business seeks to identify, classify and interpret the similarities and dissimilarities among the systems used to anticipate demand and market products. This system presents inter-country comparison and inter-continental comparison. Comparative analysis helps the management to evaluate the markets, finances, human resources, consumers etc. of various countries. It also helps the management to evaluate the market potentials of various countries.

The study also indicates the degree of consumer acceptance of the product, product changes and development in different countries. Managements of international business houses can group countries with similar features and design the same products, fix similar price and formulate the same marketing strategies.

For example Prentice-Hall grouped India, Nepal, Pakistan, Bangladesh, Sri Lanka etc. into one category based on customer's ability to pay and designed the same quality product and sold them at the same price in all these countries.

Chapter 2 – Differences between Domestic Business Operations and International Business Operations

Many well known business units are highly successful in their home countries. However they are not able to face the challenges abroad. On the other hand there are organizations which do very well in international business but they lose out in the local arena. There are a number of organizations who do business, both in the domestic and international front, successfully, by properly allocating right resources in right countries. These organizations are quick to see the advantages and disadvantages involved in both operations. If business is slow in the home country, they concentrate more on international business, and if the risk is very high international business they focus their attention on the domestic front. Understanding differences and deciding policies and strategies enable organizations to succeed or fail.

Similarities between Domestic and International Business

There are certain similarities between domestic and international business in terms of broad objectives and goals of the company, namely:

1. Generating revenue.
2. Corporate image and brand building.
3. Customer satisfaction and building loyalty as patronage buyers.
4. Carrying out their operations by respecting and adhering to local regulations.
5. Generation of employment opportunities.
6. Both are subject to a set code of conduct and ethics which includes corporate governance.

Major Macro Level differences between Domestic and International Business Operations

1. Environment:

The economic, political, legal, socio-cultural, competitive and technology environments are well known in case of domestic business due to the familiarity of geography and place of operations, hence the organization can take the necessary precautions to assess its impact and adjust quickly to the changes in the same. For examples an Indian company having established operations may not have to face unforeseen circumstances posed by the external macro environment.

In international operations the various aspects of the macro external environment are not fully known unless the business has established and created a place for itself in the market. Thus a number of innumerable hidden environmental factors may emerge during the settlement period which may pose problems. For example an Indian company which wishes to enter and establish operations in the European markets may face numerous political, legal, socio-cultural and other problems cropping up in the external macro environment during

the initial settlement stages. An apt inverse example that can be quoted in this context is that of Mc Donald's fast food chain which having entered India way back in 1996 had to ensure that it did not offer pork or beef items so as to gain acceptance locally. It also had to re-engineer its operations to address the special requirements of vegetarians in India introducing variations and dishes that were not available at any Mc Donald's outlet anywhere in the world.

2. Plan and Strategy:

Plans and strategies are generally worked out for the short terms. The short term plans are linked together and carried forward into the long run. For example Glaxosmithkline Consumer Healthcare is ready to shift into the top gear in India by doubling its revenue from Rs. 2000 Crores to Rs. 4000 Crores in the next two years through aggressive acquisitions and rapid movement in new product categories. The inverse is also possible as domestic business offers the flexibility to organizations.

In case of international business only a well thought out, proven, practical long term time-bound planning and strategy will work. Strategic inputs are required in multiples. For instance if an MNC plans to enter China, it has to have a long term multidimensional strategy as China is a very large country and is slated to become the world's largest economy by 2025 even if its GDP grows at only 6 to 7% average annual rate in the next 17 years accompanied by a 2 to 3% average annual appreciation in the yuan vis-à-vis the US Dollar.

3. Competition:

The competitive forces operating in the domestic business environment are restricted to a local boundary. The movement of competitive forces can thus be analyzed and understood more clearly.

In case of international business competitive forces are not restricted to a local boundary. They extend over several countries, thereby making it difficult to analyze their motive and movement.

4. Currency:

Domestic business operations make use of local currency for transactions. Costing, pricing, revenue and margins are accounted for in a single currency. This results in minimum volatility which does not expose the business to exchange rate risks at least in the short term.

On the other hand the transactions in international business are carried out in multiple currencies. Fluctuations in cross currency movement and associated exchange rate risks are common. Currency fluctuation influences pricing, costing and investment decision which needs to be covered by the entrepreneur by using tools such as ECGC (Export Credit and Guarantee Corporation), currency forward and future contracts.

5. Tariffs and Quotas:

The tariff rates and quotas imposed by various countries on their exports and imports do not directly and significantly influence domestic business operations.

The international businesses are directly and significantly influenced by the tariff rates imposed by various countries. Also they have to operate within the quotas of exports and imports imposed by different countries.

6. Research and Development:

It is reasonable and relatively simpler to carry out business product research, innovations, demand analysis and customer survey in domestic business. Also the reliability and success rate of their results are much higher. For e.g. Nestle Maggi has developed and introduced Vegetable Atta noodles, a variety of noodles which is available mostly only in India and not in other countries based on market research.

Research and development in international business operations is expensive and difficult to conduct. Their reliability criteria depend on individual countries and there is no uniformity in the result of their applications. Quoting the same example Nestle Maggi has developed different varieties of noodles such as Kari Letup and Pizza which are particularly sold in Malaysia and Saudi Arabia and which may not be suitable to Indian markets.

7. Human Resources:

Due to past successes, proven track record and established systems corporates can succeed in the domestic business arena even if the human resources have minimum skills and knowledge. The task of human resources management is much simpler in domestic business.

The international business arena requires multi-lingual, multi-strategic and multi-cultural human resources to handle varied risks spread over a global area in different countries. Thus the task of human resource management is much more complex.

8. Organizational Vision and Objective:

The organizational vision and objective in domestic business is narrowed down to work in a single country with a steady growth objective. For e.g. a part of the vision of Tata Steel in 1998 – 99 was “In the coming decade, we will become the most competitive steel plant and so serve the community and the nation.”

In case of international business the organizational vision and objective is more broadened to cover many countries and geographic and cultural diversity may influence the same. For e.g. the vision of Tata Steel Group’s vision currently states “We aspire to be the global steel industry benchmark for Value Creation and Corporate Citizenship”

9. Investment:

Depending on the size of domestic business operations one can start with a minimum investment. Involvement of regulatory bodies in respect of small local business enterprises is limited.

On the other hand all overseas operations except exports, call for huge investments to set up and expand the business in many countries. Special regulatory bodies are involved in the process since foreign currency is transacted.

10. Distribution:

Domestic business houses can use at its discretion to select any distribution channel to reach the customer. For e.g. small “Mom and Pop” stores are one of the most popular and widely used distribution channel for Fast Moving Consumer Goods (FMCG) in rural and urban India.

The choice of distribution channel in international business operations is governed by the government or market practice of the nation where the business is operating. For e.g. Cash and carry stores and shopping malls which are very commonly used channels in the developed markets are now catching up in urban India.

11. Logistics:

Domestic business may involve use of conventional logistical methods engaging domestic players for procurement of raw materials and reaching of final products to the consumer. For e.g. hand drawn carts and cycles are very commonly used means of transportation in the local Indian business operations even today.

International business engages international players involving advanced technology and systems for effective logistical operations. For e.g. containerized transportation is the standard form of reaching the goods to the required destination in most developed nations.

12. Advertising and Promotion:

Advertising, personal selling and other promotional methods are subject to the regulations prevailing in the domestic business operations. For e.g. advertisement and promotion of pharmaceutical drugs, cigarettes and alcohol are restricted in India.

In case of international business different countries have different regulations with regard to advertisement and promotion. For e.g. advertisements of cigarettes and alcohol are permitted in some developed nations.

13. Legal Aspects:

In respect of domestic business only the local laws and regulations are fully applicable to conduct business. There is minimum adherence to international regulations related to Intellectual Property Rights in domestic operations.

In case of international business, international regulations and host country laws are applicable. Developed countries impose strict regulations as compared to Least Developed Countries (LDCs)

14. Approach:

Domestic business's approach is ethnocentric. It means that domestic companies formulate strategies, product design etc. towards national markets, customers and competitors.

International business's approach can be polycentric, regiocentric or geocentric. Under polycentric approach international business enters foreign markets by establishing foreign subsidiaries. Under regiocentric approach, they export the product to the neighbouring countries of the host country. Under the geocentric approach, they treat the entire world as a single market for production, marketing, investment and drawing various inputs.

Chapter 3 – Reasons to Enter International Business

All organizations irrespective of whether they are small or medium or large, are keen to enter into international business. Established companies are expanding their business. Many countries encourage trade, and removal of strangulating trade barriers motivates companies to aggressively multiply their targets. The governments of various countries are also determined to make their economy grow through international business, which has therefore become an inevitable part of their economic policy. The motive behind international business can be looked at:

- A. From an individual company's viewpoint
- B. From the government's viewpoint

From an individual company's viewpoint

1. Managing the product life cycle:

All companies have products which pass through different stages of their lifecycles. After the product reaches the last stage of the cycle called the declining stage in on country, it is important for the company to identify a few other countries where the whole life cycle stages could be encased. For example, Enfield India reached maturity and the declining stage in India for the 350cc Royal Enfield motorcycle. The company entered Kenya, West Indies, Mauritius and other destinations where the heavy engine two wheeler became popular. The Suzuki 800cc vehicle reached the last stage of its life cycle in Japan, and entered India in the early 1980s, where it is still doing good business as the bread and butter model in Maruti Udyog Ltd's stable.

2. Geographic expansion as a growth strategy:

Even if companies expand their business at home, they may still look overseas for new markets and better prospects. For example, Arvind Mills expanded their business by either setting up units or opening warehouses abroad. Ranbaxy's growth is mainly attributed to geographic expansion every year to new territories.

3. The adventurous spirit of younger generation in the organization:

The younger generation of business families have considerable international exposure. They are willing to take risks and challenges and also create opportunities for their business. For example Kumar Mangalam Birla of the Aditya Vikram Birla Group of companies has managed to establish their business operations in several countries across the globe in the last decade.

4. Corporate ambition:

Every corporate in the country has strategic plans to multiply its sales turnover. In case some of the ventures fail, others will offset the losses because of multi-locational operations. For example Coca cola is not doing well in a number of countries including India. But this will not affect the company because more than a hundred countries are contributing to offset the losses.

5. Technology advantage:

Some companies have outstanding technology through which they enjoy core competencies. There is a need for such technology in all the countries. Biocon, Infosys and Tata Consultancy are known for their core competencies in biotechnology and software development respectively and a huge demand exists across many developed economies of the world for their technology.

6. Building a corporate image:

Prior to profits and revenue generation, many companies first build their corporate image abroad. Once the image is built up, generating revenue is a comparatively easy task. For example LG Electronics and Samsung Electronics built their image in India during the initial three to five years after their entry and generation of revenues and profits has been considerable as they have expanded to semi-urban and rural India overtaking traditional Indian brands Godrej and Videocon.

7. Incentives and business impact:

Companies, which are involved in international business, enjoy fiscal, physical and infrastructural incentives while they set up business in the host country. The Aditya Vikram Birla group enjoyed such incentives in Thailand and Indonesia. The home country may also offer many incentives in order to neutralize the cost and allow the country to compete in the world market. For example recently the Prime Minister of Bangladesh Sheikh Hasina invited Indian companies to invest in proposed Special Economic Zones (SEZ) offering infrastructure facilities and tax holidays to such Indian companies.

8. Labour advantage:

Many companies have a highly productive labour force. The unique skills may not be available throughout the world. Manufacturing units in India have consistently performed well, whether in the diamond industry (E.g. Surat) or automobile manufacturing (E.g. Hyundai Motor car manufacturing plant near Chennai). Companies nurture the skills of such labour force and win world markets.

9. New business opportunities:

Many companies have entered into businesses abroad, seeing unlimited opportunities. For example health care companies like Cipla, Dr. Reddys Laboratories and Aurobindo Pharma have entered into South American countries like Brazil and Argentina looking at the attractive business opportunities in such countries.

From a government viewpoint:

1. Earning valuable foreign exchange:

Foreign exchange is necessary to balance the payments for imports. India imports crude oil, defence equipment, essential raw materials and medical equipment for which the payments have to be made in foreign exchange. If the exports are greater than imports it indicates a surplus in the balance of payments, on the other hand if the imports are higher and the exports are lower as has always been the case with India it indicates an adverse balance of payment.

2. Interdependency of nations:

From time immemorial, nations have mutually depended on each other. Even during the era of Indus Valley civilization, Egypt and the Indus Valley depended on each other for various items. Today India depends on the Gulf regions for crude oil and in turn the Gulf region depends on India for rice, tea etc. Developed countries depend on developing countries for primary good, whereas developing countries depend on developed countries for value added finished products.

3. Trade theories and their impact:

The theories of absolute advantage, comparative advantage and competitive advantage, which have been propounded by classical economists, indicate that a few nations have cost advantages in procurement of resources and production of finished products than other nations. Such advantages enable them to be competitive. These resources may be in the form of labour, infrastructure, technology, natural resources or even a proactive policy of the government. For example falling land prices in the South American countries of Paraguay and Uruguay has thrown open a tremendous opportunity for India edible oil companies to venture into offshore oilseeds cultivation with the industry representative body Solvent Extractor's Association (SEA) negotiating with ICICI Bank for a Rs. 150 Crore loan to part the proposed investment in the project.

4. Diplomatic relations:

Diplomacy and trade always go hand in hand. Many sovereign nations send their diplomatic representatives to other countries with a motive of promoting trade besides maintaining cordial relations. Indian diplomats in Latin America have

done a remarkable job of promoting India's business in the 1990s. However Pakistan being a failed nation has not been much successful in this endeavor

5. Core competency of nations:

Many countries are endowed with resources, which are produced at an optimum level. Such countries can compete well anywhere in the world. Rubber products from Malaysia, knitwear from India, rice from Thailand and wool from Australia are a few illustrations.

6. Investment for infrastructure:

Over the years all countries have invested huge amounts of money on infrastructure by building airports, sea ports, economic zones and inland container terminals. If the trade activities do not increase and flourish, the country cannot recover the amounts invested. Hence, the government fixes targets for every infrastructure unit and time frame to achieve them. Economies like Mauritius, Hong Kong, Singapore, Malta and Cyprus invest in trade related infrastructure in order to elevate themselves to be foreign trade oriented economies.

7. National image:

A new era has emerged from conquering countries by sword to winning by trade. A businessman gives priority to the image of the country he belongs to. We come across products with labels such as 'Made in Japan', 'Made in China' and 'Made in India'. Businessmen from Japan, China and India endeavor to make their products world class and bring credentials to their country while citizens achieve business success elsewhere in the world.

8. Foreign trade policy:

All developing countries announce their foreign trade policies. A clear cut road map is drafted and given to promotional bodies so that timely implementation is possible. For instance the Commerce and Industry ministry Mr Anand Sharma has assured that the Government of India would extend its support to the slowdown hit export sector by providing more sops in the Foreign Trade Policy (FTP) to be unveiled next month at a conference organized by the industry body Federation of Indian Chambers of Commerce and Industry (FICCI). He said that the FTP would be a mix of fiscal incentives and simplification of procedures for carrying out foreign trade.

9. National targets:

By the year 2010, India aims to have a two percent share of the global market from the current level of one percent. Indian exports in 2007-08 were \$154.73 Billion and India has set an export target of \$200 Billion for 2009-10.

10. WTO and international agencies:

The apex body of world trade, the World Trade Organization (WTO), a free, transparent and regulatory body upholds provisions related to elimination or reduction of tariff and non-tariff barriers. The International Bank for Reconstruction and Development (IBRD), popularly called the World Bank extends financial assistance on a soft loan basis in order to assist developing countries in their infrastructure and industrial development. The International Monetary Fund (IMF) maintains currency stability in various countries through regulatory mechanisms. Many more organizations like International Maritime Organization, International Standard Organization, International Telecommunication Union, International Civil Aviation Organization are major catalysts to promote trade between nations.

Chapter 4 – Modes of Entry and Operation in International Business

Modes of Entry and Operation:

Companies desiring to enter the foreign markets, face the dilemma while deciding method of entry into a given overseas location. Companies can reduce this dilemma by analysing the decision factors.

Decision Factors:

After deciding to go to foreign markets, the companies have to decide the mode of entry. This dilemma can be solved to some extent by considering the following factors:

- Ownership Advantages
- Location Advantages
- Internationalisation Advantages

i) Ownership Advantages:

Ownership advantages are those benefits designed by a company by owning resources. These benefits provide competitive advantage to the company over its competitors. These advantages are both tangible and intangible.

EXAMPLE: Toronto-based Inco. Ltd., of rich, nickel-bearing ores allowed the company to dominate the production of both primary nickel and nickel-based metal alloys.' Similarly, Tata Iron and Steel Company (TISCO) Ltd. owned its iron ore mines and coal mines. This ownership grants the advantage of low cost producer to the company.

(ii) Location Advantages:

Certain locational factors grant benefit to the company when the manufacturing facilities are located in the host country rather than in the home country. These locational factors include:

- Customer Needs, Preferences and Tastes
- Logistic Requirements
- Cheap Land Acquisition Cost
- Cheap Labour
- Political Stability
- Low Cost Raw Materials
- Climatic Conditions.

If the company has locational advantages, it enters foreign markets through direct investment. Otherwise, if the location of manufacturing facilities in home country is advantageous than in host country, the company enters foreign markets through exporting.

EXAMPLE: McDonalds built a factory in Cairo, Egypt in 1996 due to its frustration in dealing with Egyptian rules. Bureaucrats in Egypt required the company to obtain more than dozen signatures each time it imported hamburger buns into Egypt.

(iii) Internationalisation Advantages:

Internationalisation advantages are those benefits that a company gets by manufacturing goods or rendering services in the host country by itself rather than through contract arrangements with the companies in the host country. Sometimes the cost of negotiating, monitoring and enforcing an agreement with the host country's company would be difficult and costly. In such cases the company enters the international markets through direct investment. Otherwise, if the company thinks that the transaction costs are low, and the local companies in the host country can produce efficiently without jeopardising the interest, the company can enter the foreign markets through contract manufacturing, franchising or licensing.

Different Modes of Entering Into International Markets:

A) EXPORTING

1. Indirect Exports
2. Direct Exports
3. Intercorporate Transfers

B) LICENSING

1. International Licensing

C) FRANCHISING

1. International Franchising

D) SPECIAL MODES

1. Contract Manufacturing
 - Management Contracts
 - Turnkey Projects

E) FOREIGN DIRECT INVESTMENT WITH ALLIANCES

1. Green Field Strategy

F) FOREIGN DIRECT INVESTMENT WITHOUT ALLIANCES

1. Mergers and Acquisitions
2. Joint Ventures

The first one in the modes of entry is exporting:

A.EXPORTING:

Exporting is the easiest and most widely used mode of entering in international markets. Exporters can be classified in various ways:

1. Depending upon the size of the business, they are classified as small or large exporters. Current foreign trade policy in India provides incentives and facilities to promote both small exporters and large exporters who are status holders due to their performance in earning foreign exchange.
2. Depending upon the product lines exported, they are classified as single product or multi product exporters.
3. Depending upon their legal status they are classified as proprietary companies, partnership companies, private limited companies and public limited companies.
4. Depending upon the destination of their exports, they are classified as single destination exporters or multi destination exporters. Nowadays, the majority of companies adopt the philosophy of multi product, multi locational, multi strategic and multi dimensional operations.
5. Depending upon the frequency of their exports they are classified as occasional exporters and dynamic exporters.

Exporting includes indirect exporting, direct exporting and intracorporate transfers.

1. Indirect Exporting

Indirect exporting is exporting the products either in their original form or in the modified form to a foreign country through another domestic company. Various publishers in India including Himalaya Publishing House sell their products i.e books to UBS publishers of India, which in turn exports these books to various foreign countries

2. Direct Exporting

Direct exporting is selling the products to a country directly through its distribution arrangement or through a host country's company. Baskin Robins initially exported its ice cream to Russia in 1990 and later opened 74 outlets with Russian partners. Finally in 1995 it established its ice cream plant in Moscow.

3. Intracorporate Transfers

Intracorporate transfers means selling of product; by a company to its affiliated company in host country (another country). *For example* Selling of products by Hindustan Lever in India to Unilever in USA This transaction is treated as exports in India and imports in USA.

Factors to be considered by a company while exporting:

- Government policies like export policies, import policies, export financing, foreign exchange.
- Marketing factors like image, distribution networks, responsiveness to the customer, customer awareness and customer preferences
- Locational consideration: These factors include physical distribution costs, warehousing costs, transportation costs, inventory carrying costs etc.

B. LICENSING:

International Licensing:

Licensing is defined as “the method of foreign operation whereby a firm in one country agrees to permit a company in another country to use the manufacturing, processing, trademark, know-how or some other skill provided by the licensor”.

Coca Cola is an excellent example of licensing. In Zimbabwe, United Bottlers have the license to make Coke.

International licensing is an agreement between the licensor and the licensee over a period of time for the use of brand name, marketing knowhow, copyright, work method, and trade mark by paying a licence fee. For example, British American tobacco company (BATS) has given licenses in many countries for the manufacture of their brand of cigarettes “555”. In India, ITC is the licensed producer of “555”.

Pepsi cola granted license to Heineken of the Netherlands giving them the exclusive right to produce and sell Pepsi cola in the Netherlands. The licensor has minimum involvement in day to day functions. Therefore, the returns are also comparatively low.

The domestic company can choose any international location and enjoy the advantages without incurring any obligations and responsibilities of ownership, managerial, investment etc.

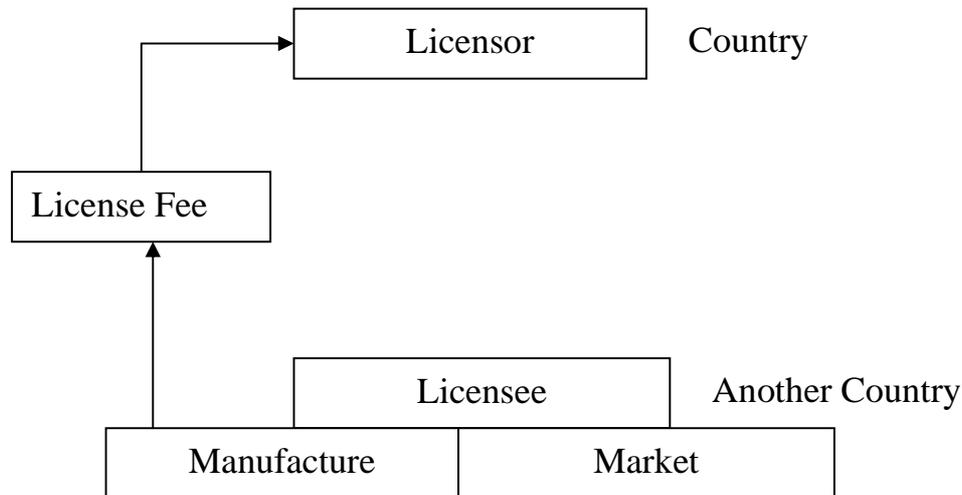
Licensing gives the following advantages:

- Good way to start in foreign operations and open the door to low risk manufacturing relationships
- Linkage of parent and receiving partner interests means both get most out of marketing effort
- Capital not tied up in foreign operation and Options to buy into partner exist or provision to take royalties in stock.

The disadvantages are:

- Limited form of participation - to length of agreement, specific product, process or trademark
- Potential returns from marketing and manufacturing may be lost
- Partner develops know-how and so licence is short
- Licensees become competitors - overcome by having cross technology transfer deals and
- Requires considerable fact finding, planning, investigation and interpretation.

Licensing Concept:



One Country or More Countries

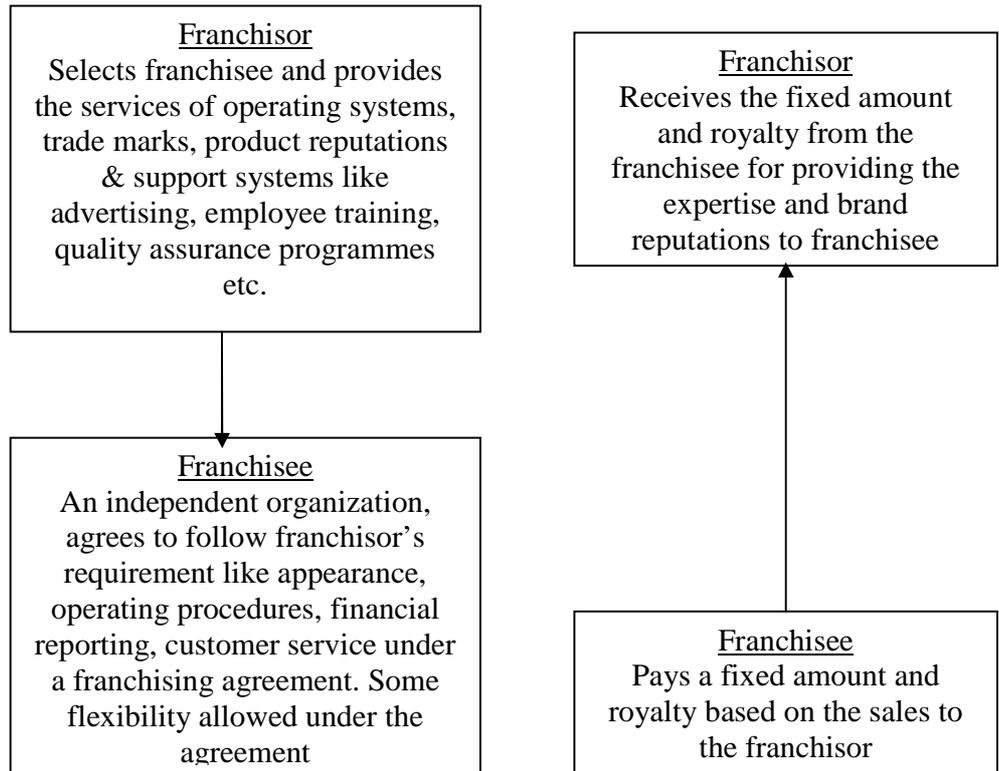
C. FRANCHISING

Franchising refers to the methods of practicing and using another person's business philosophy. The franchisor grants the independent operator the right to distribute its products, techniques, and trademarks for a percentage of gross monthly sales and a royalty fee. Various tangibles and intangibles such as national or international advertising, training, and other support services are commonly made available by the franchisor. Agreements typically last from five to thirty years, with premature cancellations or terminations of most contracts bearing serious consequences for franchisees.

Franchising has been around for many centuries but did not come to prominence until the 1930s, when the establishment of electricity, vehicles, and, in the 1950s, the Interstate Highway system helped propel modern franchising, most notably franchise-based food service establishments. According to the International Franchise Association approximately 4% of all businesses in the United States are franchises.

Businesses for which franchising is said to work best have the following characteristics:

- Businesses with a good track record of profitability.
- Businesses built around a unique or unusual concept.
- Businesses with broad geographic appeal.
- Businesses which are relatively easy to operate.
- Businesses which are relatively inexpensive to operate.
- Businesses which are easily duplicated.



Advantages:

For franchisors:

Expansion:

Franchising is one of the only means available to access venture investment capital without the need to give up control of the operation of the chain in the process. After the brand and formula are carefully designed and properly executed, franchisors are able to sell franchises and expand rapidly across countries and continents using the capital and resources of their franchisees, and can earn profits commensurate with their contribution to those societies while greatly reducing the risk and expense that would be inherent in conventional chain operations

Legal considerations:

The franchisor is relieved of many of the mundane duties necessary to start a new outlet, such as obtaining the necessary licenses and permits. In some jurisdictions, certain permits (especially alcohol licenses) are more easily obtained by locally based, owner-operator type applicants while companies based outside the jurisdiction (and especially if they originate in another country) find it difficult if not impossible to get such licences issued to them directly. For this reason, hotel and restaurant chains that sell alcohol often have no viable option but to franchise if they wish to expand to another state or province.

Operational considerations:

Franchisees are said to have a greater incentive than direct employees to operate their businesses successfully because they have a direct stake in the start up of the branded

business and the tangible assets that wear the brand name. The need of franchisors to closely scrutinize the day to day operations of franchisees (compared to directly-owned outlets) is greatly reduced.

For franchisees:

Employment:

As practiced in retailing, franchising offers franchisees the advantage of starting up a new business quickly based on a proven trademark and formula of doing business, as opposed to having to build a new business and brand from scratch (often in the face of aggressive competition from franchise operators).

Expansion:

With the help of the expertise provided by the franchisors, the franchisees may be able to take their franchised businesses to a level which they wouldn't have been able to without the expert guidance of their franchisors.

Training:

Franchisors often offer franchisees significant training, which is not available for free to individuals starting their own business. Although training is not free for franchisees, it is sometimes supported through the traditional franchise fee that the franchisor collects and tailored to the business that is being started. When training fees and travel expenses, etc. are required beyond the initial franchise fee, these fees are deductible as part of the startup expenses of the business.

Disadvantages:

For franchisors:

Control:

Successful franchising necessitates a much more careful vetting process when evaluating the limited number of potential franchisees than would be required in the hiring of direct employees who may have experience in the concept sector. An incompetent manager of a directly-owned outlet can easily be replaced, while, regardless of the local laws and agreements in place, removing an incompetent franchisee who owns the tangible assets of the business is much more difficult. Incompetent franchisees can easily damage the public's goodwill towards the franchisor's brand by providing inferior goods and services. If a franchisee is cited for legal violations, (s)he will probably face the legal consequences alone but the franchisor's reputation could still be damaged.

Limited pool of viable franchisees

In any city or region there may be only a limited pool of prospects who have both the financial resources and the desire to purchase and start up a franchised business, as compared to the pool of individuals who can be hired and trained to competently manage directly-owned businesses, as paid employees. However, in periods of recession where traditional good jobs are in short supply, this disadvantage disappears because those who can't find good jobs are willing to invest money in a franchise as a means of self-employment.

For franchisees:

No guarantee:

Usually, there is no guarantee of financial success for the franchisee made by the franchisor in the written disclosure circular and the actual franchise agreement. While the estimated startup costs of the franchise are an implied "earnings claim" some businesses do fail, including franchised outlets. Unfortunately, the unit financial performance statistics are not required to be disclosed to new buyers of franchises under Federal Regulatory Policy, the FTC Rule, and this omission makes it impossible for new buyers of franchises to assess the odds of success and failure of their investment in the franchise in terms of profitability and failure as experienced on a unit basis of the franchise system.

Control:

For franchisees, the main disadvantage of franchising is a loss of control. While they gain the use of a system, trademarks, assistance, training, marketing, the franchisee is required to follow the system and get approval for changes from the franchisor. For these reasons, franchisees and entrepreneurs are very different.

Price:

Starting and operating a franchise business carries expenses. In choosing to adopt the standards set by the franchisor, the franchisee often has no further choice as to signage, shop fitting, uniforms etc. The franchisee may not be allowed to source less expensive alternatives. Added to that is the franchise fee and ongoing royalties and advertising contributions. The contract may also bind the franchisee to such alterations as demanded by the franchisor from time to time.

Conflicts:

The franchisor/franchisee relationship can easily cause conflict if either side is incompetent (or acting in bad faith). An incompetent franchisor can destroy its franchisees by failing to promote the brand properly or by squeezing them too aggressively for profits. Franchise agreements are unilateral contracts or contracts of adhesion wherein the contract terms generally are advantageous to the franchisor when there is conflict in the relationship.

D. SPECIAL MODES:

These have special strategies and include:

1) Turnkey Projects:

Turn-key refers to something that is ready for immediate use, generally used in the sale or supply of goods or services. The term is common in the construction industry, for instance, in which it refers to the bundling of materials and labor by sub-contractors. A "turnkey" job by a plumber would include the parts (toilets, tub, faucets, pipes, etc.) as well as the plumber's labor, without any contribution by the general contractors.

This is commonly used in motorsports to describe a car being sold with drivetrain (engine, transmission, etc.) as a racer may prefer to keep the pieces to use in another vehicle to preserve a combination. Similarly, this term may be used to advertise the sale

of an established business, including all the equipment necessary to run it, or by a business-to-business supplier providing complete packages for business start-up.

Use in business

In a turnkey business transaction, different entities are responsible for setting up a plant or equipment (e.g. trains/infrastructure) and for putting it into operation. It can include contractual actions - at least through the system, subsystem, or equipment installation phase. It may also include follow-on contractual actions, such as testing, training, logistical, and operational support. It is often given to the best bidder in a procurement process.

Turnkey projects can also be extended, known as turnkey plus, where there is perhaps a small equity interest by the supplier and it will later on continue its operation through a management contract or licensing.

Turnkey is often used to describe a home built ready for the customer to move in. If a contractor builds a "turnkey home" they frame the structure and finish the interior. Everything is completed down to the cabinets and carpet.

2) Management Contracts:

A management contract is an arrangement under which operational control of an enterprise is vested by contract in a separate enterprise which performs the necessary managerial functions in return for a fee. Management contracts involve not just selling a method of doing things (as with franchising or licensing) but involves actually doing them. A management contract can involve a wide range of functions, such as technical operation of a production facility, management of personnel, accounting, marketing services and training.

Management contracts have been used to a wide extent in the airline industry, and when foreign government action restricts other entry methods. Management contracts are often formed where there is a lack of local skills to run a project. It is an alternative to foreign direct investment as it does not involve as high risk and can yield higher returns for the company.

3) Contract Manufacturing:

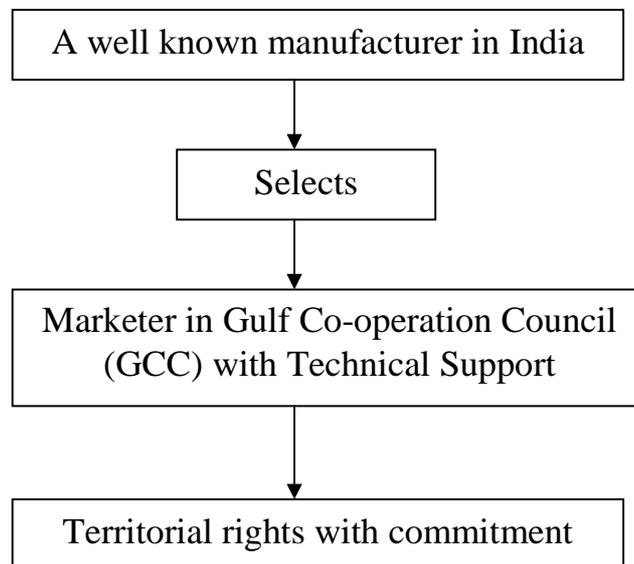
Contract manufacturing is a process that established a working agreement between two companies. As part of the agreement, one company will custom produce parts or other materials on behalf of their client. In most cases, the manufacturer will also handle the ordering and shipment processes for the client. As a result, the client does not have to maintain manufacturing facilities, purchase raw materials, or hire labor in order to produce the finished goods.

The basic working model used by contract manufacturers translates well into many different industries. Since the process is essentially outsourcing production to a partner who will privately brand the end product, there are a number of different business ventures that can make use of a contract manufacturing arrangement. There are a number of examples of pharmaceutical contract manufacturing currently functioning today, as well as similar arrangements in food manufacturing, the creation of computer components and other forms of electronic contract manufacturing. Even industries like

personal care and hygiene products, automotive parts, and medical supplies are often created under the terms of a contract manufacture agreement.

There are several advantages to a contract manufacturing arrangement. For the manufacturer, there is the guarantee of steady work. Having contracts in place that commit to certain levels of production for one, two and even five year periods makes it much easier to forecast the future financial stability of the company. For the client, there is no need to purchase or rent production facilities, buy equipment, purchase raw materials, or hire and train employees to produce the goods. There are also no headaches from dealing with employees who fail to report to work, equipment that breaks down, or any of the other minor details that any manufacturing company must face daily. All the client has to do is generate sales, forward orders to the manufacturer, and keep accurate records of all income and expenses associated with the business venture.

Contract manufacturing process



E. FOREIGN DIRECT INVESTMENT WITHOUT ALLIANCES

Some companies enter the foreign markets through exporting, licensing, franchising etc., get the knowledge and awareness of the foreign markets, culture of the country, customers' preferences, political situation of the country etc and then establish manufacturing facilities by ownership in the foreign countries. Baskin Robbin's in Russia followed this strategy

Greenfield investment

A form of foreign direct investment where a parent company starts a new venture in a foreign country by constructing new operational facilities from the ground up. In addition to building new facilities, most parent companies also create new long-term jobs in the foreign country by hiring new employees.

This is opposite to a brown field investment.

Green field investments occur when multinational corporations enter into developing countries to build new factories and/or stores.

Developing countries often offer prospective companies tax-breaks, subsidies and other types of incentives to set up green field investments. Governments often see that losing corporate tax revenue is a small price to pay if jobs are created and knowledge and technology is gained to boost the country's human capital.

F. FOREIGN DIRECT INVESTMENT WITH STRATEGIC ALLIANCES

Innovations, creations, productivity, growth, expansions and diversifications in recent years are mostly accomplished by strategic alliances adopted by various companies like mergers, acquisitions and joint ventures.

Strategic alliances are a co-operative approach to achieve the larger goals. Strategic alliances take different forms like licensing, franchising, contract manufacturing, JVs etc. Alliances are a strategy to explore a new market which the companies individually cannot do. Example: Xerox of USA and Fuji of Japan collaborated to explore new markets in Europe and Pacific Rim

1) Mergers and Acquisition

International mergers and acquisitions are growing day by day. These mergers and acquisitions refer to those mergers and acquisitions that are taking place beyond the boundaries of a particular country. International mergers and acquisitions are also termed as global mergers and acquisitions or cross-border mergers and acquisitions.

Globalization and worldwide financial reforms have collectively contributed towards the development of international mergers and acquisitions to a substantial extent. International mergers and acquisitions are taking place in different forms, for example horizontal mergers, vertical mergers, conglomerate mergers, congeneric mergers, reverse mergers, dilutive mergers, accretive mergers and others.

International mergers and acquisitions are performed for the purpose of obtaining some strategic benefits in the markets of a particular country. With the help of international mergers and acquisitions, multinational corporations can enjoy a number of advantages, which include economies of scale and market dominance.

International mergers and acquisitions play an important role behind the growth of a company. These deals or transactions help a large number of companies penetrate into new markets fast and attain economies of scale. They also stimulate foreign direct investment or FDI.

The reputed international mergers and acquisitions agencies also provide educational programs and training in order to grow the expertise of the merger and acquisition professionals working in the global merger and acquisitions sector.

The rules and regulations regarding international mergers and acquisitions keep on changing constantly and it is mandatory that the parties to international mergers and acquisitions get themselves updated with the various amendments. Numerous investment bank professionals, consultants and attorneys are there to offer valuable and knowledgeable recommendations to the merger and acquisition clients.

Methods of Financing International Mergers and Acquisitions:

Usually, the following methods are implemented for funding international mergers and acquisitions:

- Financing (or taking loans)

- Cash
- Factoring
- Hybrid Financing

2) Joint venture:

A Joint Venture is an entity formed between two or more parties to undertake economic activity together. The parties agree to create a new entity to share in the revenues, expenses, and control of the enterprise. Joint ventures can be defined as "an enterprise in which two or more investors share ownership and control over property rights and operation". The venture can be for one specific project only, or a continuing business relationship.

Entering into a joint venture is a major decision. Businesses of any size can use joint ventures to strengthen long-term relationships or to collaborate on short-term projects.

Advantages:

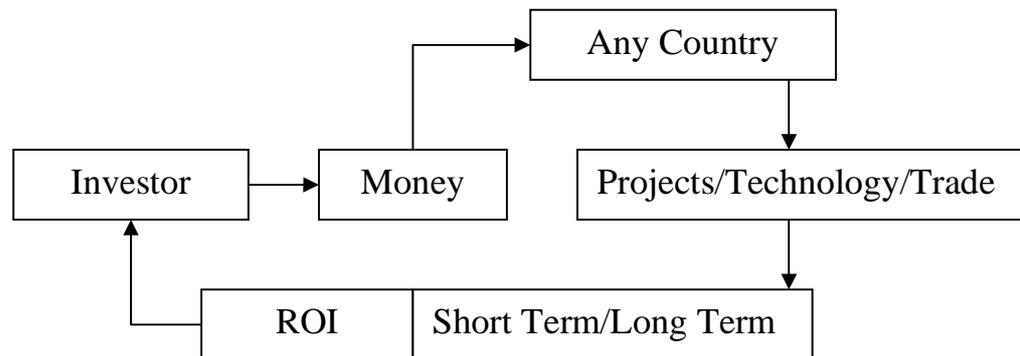
- Forming JVs is a popular strategy when venturing abroad because it combines the expertise of the foreign company and the market of the local company.
- Sharing of risks with a partner
- Joint financial strength
- A JV also shares the costs and risks of venturing into a new country.
- In fact, JVs are sometimes the only permitted way to penetrate a market, as some countries impose having a local partner as a market-entry criterion
- Access to new markets and distribution networks
- Access to greater resources, including specialized staff and technology

Partnering with another business can be complex. It takes time and effort to build the right relationship.

Disadvantages:

- Loss of effective management control can be a major disadvantage of the joint venture with a local owner. The local owner may hold majority ownership of the joint venture and may have a greater say in business decisions and his lack of expertise could result in reduced profits,
- Shared profits are another huge disadvantage of the joint venture.
- Potential for conflict with your partner
- Might lead to an imbalance in levels of expertise, investment or assets brought into the venture by the different partners
- Different cultures and management styles result in poor integration and co-operation

Investment Flow in an FDI:



Case Study: Boeing Maintenance Refurbishment and Overhaul (MRO) facility on track at Nagpur

Boeing, the Seattle-based, aircraft manufacturing company revealed that it was firm on its commitment to invest \$100 Million in the Special Economic Zone, Multimodal International Passenger and Cargo Hub, Nagpur (MIHAN) project. It did this by signing the much delayed 99-year lease agreement for 50 acres of land located adjacent to the Dr. Babasaheb Ambedkar International Airport, Nagpur with the Maharashtra Airport Development Company (MADC) for setting up its Maintenance, Refurbishment and Overhaul (MRO) Facility on January 31, 2009. Boeing had named Nagpur city as the location for its planned MRO facility in 2006. The facility is a joint venture between Boeing and Air India, while MADC, a government agency has provided the land. Boeing agreed to establish an MRO facility and provide training as part of a 68-airplane order placed by Air India in December 2005. It is the largest airplane order in India's civil aviation history and it includes a combination of Boeing 777s, 787s and 737s that the operator will use for renewal and expansion of its all Boeing fleet.

Currently India sends its aircrafts to countries like Qatar and Singapore for maintenance where Indian engineers service the aircraft owing to the absence of an MRO facility thereby increasing the costs of the domestic airlines that have to send their aircraft abroad for servicing. India also loses out on the business opportunities of servicing the domestic aircrafts and the other aircrafts in the region. Boeing had decided to set up the MRO in Nagpur since besides its central geographic location, there is ample availability of manpower and land. Most importantly the generally dry weather of Nagpur was ideal for aircraft overhauling as parts do not corrode in a climate virtually without any humidity. Apart from this, Nagpur is the only airport in the country, which has an SEZ next to it. Hopefully the facility would be functional by end of 2010, according to Boeing Senior Vice-President, Dinesh Keskar. Strong economic growth, increased market liberalization, airport privatization, and travel to and within the country are fueling a bright outlook for aviation in India. Boeing's forecast suggests that India will need 856 airplanes worth \$72.6 billion in the next 20 years to meet the air travel demand.

Chapter 5 – Current Trends in International Business

International Business has become global because practically all 200 countries of the world now engage in international trade and investment to a significant degree. This trend is facilitated by easier and cheaper communication and transportation as well as by countries opening their borders to foreign goods, services, capital, labor, technology and firms. This development is threatened by wars, political upheavals, economic recessions and anti-foreign feelings - as has always happened in the history of business and is now expressed in opposition to "globalization."

Current Trends in International Trade

Trade is increasingly recognized as a vital engine for economic development, hence it has evolved over the years to become more speedier, smoother and robust on account of the following developments

Developing countries' trade:

In 2004, the share of developing countries in world merchandise trade stood at 31%, having increased from about 20% in the mid-1980s [World Trade Organization (WTO), 2005; United Nations Conference on Trade And Development (UNCTAD), 2004]. This is the highest level since 1950. It is observed that developing countries are increasingly becoming an important destination for the exports of developed countries. Among those, in particular, some problems have been recognized in identifying tariff classification and assessing the Customs value of second-hand goods such as used cars, computer equipment, machinery and clothing. Also, developing countries contributed more to the 2003 growth of world merchandise trade than developed countries. It was estimated that nearly four-fifths of the real growth in 2003 was attributable to developing countries, including transition economies (UNCTAD, 2004). This trend requires caution, given that many developing countries, including African countries, Less Developed Countries (LDCs) and Small Island Developing States (SIDS) remain relatively marginalized from international trade (UNCTAD, 2005).

South-South Trade:

Merchandise trade between developing countries, i.e. South-South trade, has significantly increased at an annual average rate of 11% during the past decade, accounting for nearly 13% of world merchandise trade in 2000 (UNCTAD, 2005). Around 40% of exports from developing countries were destined for other developing countries. Intra-regional trade, in particular through RTAs, played a central role in the rise of South-South trade. Also, inter-regional trade showed signs of growth, albeit on a smaller basis. In addition, intra-Asia trade took a dominant position in this trend, accounting for around 80% of the total South-South trade in 2000, but strong growth in intra-regional trade in Africa and Latin America was also observed.

Intra-firm Trade:

Intra-firm trade, i.e. trade within the same company and/or its affiliates, reportedly accounts for around one-third of world merchandise trade, although aggregate data are only available for a few countries [Organization for Economic Co-operation and Development (OECD), 2002]. In the case of the US, for example, it accounted for 36.2% of exports and 39.4% of imports in 1999, having remained stable over the 1990s. In Japan, on the other hand, it accounted for 30.8% of exports and 23.6% of imports in 1999, which have significantly increased over the same period.

E-commerce:

Electronic commerce (e-commerce, described as “doing business electronically”) has become a dominant factor in international trade and business, although traditional methods of trade and business continue to be utilized widely. For example, the use of Information and Communication Technology (ICT) such as Internet communication has made cross-border activities easier and more practical (OECD, 2002). It can reduce business costs in seeking potential foreign business partners, as well as improve a firm’s visibility in global marketing services, in particular for Small and Medium Enterprises (SMEs). In addition, it allows sellers to reach potential buyers for their products beyond their national borders. In other words, it enables firms to take more opportunities to expand their business in global markets. As a result, trade patterns are changing, for example, smaller shipments are increasing, and different goods are exported to and imported from more countries.

Internationalization of Small and Medium Enterprises (SMEs):

SMEs increasingly play an important role in emerging business models in the international supply chain. As large companies pursue production specialization as well as seek external complementary service resources, SMEs may gain growing business opportunities to be integrated into the global economy. There are many ways of internationalizing SMEs, for example by forming strategic alliances with trading companies mergers and acquisitions (M&As), and inter-firm networking (OECD, 2004). ICT such as Internet is also one of the driving elements in the internationalization of SMEs. At present, a number of SMEs have already participated in international trade (OECD, 2004). In the European Union, for example, around 40% of over 4 million firms that exported goods in 2001-02 were SMEs. In the United States, SMEs having fewer than 20 employees constituted around two-thirds of exporting firms in 1999. In Australia, nearly 70% of exporting firms and over 60% of importing firms were SMEs in 2001.

Recent Statistical Data on World Trade as per the World Trade Report-2009

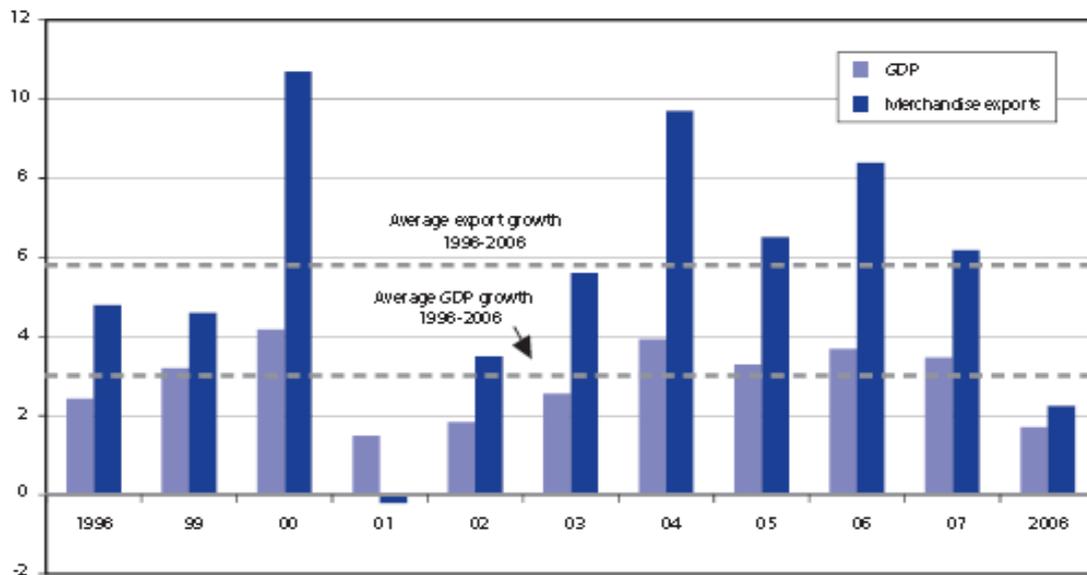
Merchandise Trade Volume in Real Terms:

In the last few months trade has contracted more than at any time since the 1930s, reflecting the dramatic global economic downturn provoked in the first instance by the collapse of major financial institutions. Signs of a sharp deterioration in the global

economy were evident in the second half of 2008 and the first few months of 2009 as world trade flows sagged and production slumped, first in developed economies and then in developing countries. Although world trade grew by 2 per cent in volume terms over the course of 2008, it tapered off in the last six months of the year and was well down on the 6 per cent volume increase posted in 2007. World output measured by real gross domestic product (GDP) also slowed appreciably, falling to 1.7 per cent in 2008 from 3.5 per cent a year earlier. Merchandise trade in volume terms (excluding the price and exchange rate fluctuations) expanded by 2 per cent in 2008, down from 6 per cent in 2007. Growth for 2008 was below the average 5.7 per cent registered during the 1998-2008 period. Growth in merchandise trade was very close to GDP growth.

Growth in the volume of world merchandise trade and GDP, 1998-2008

(Annual percentage change)



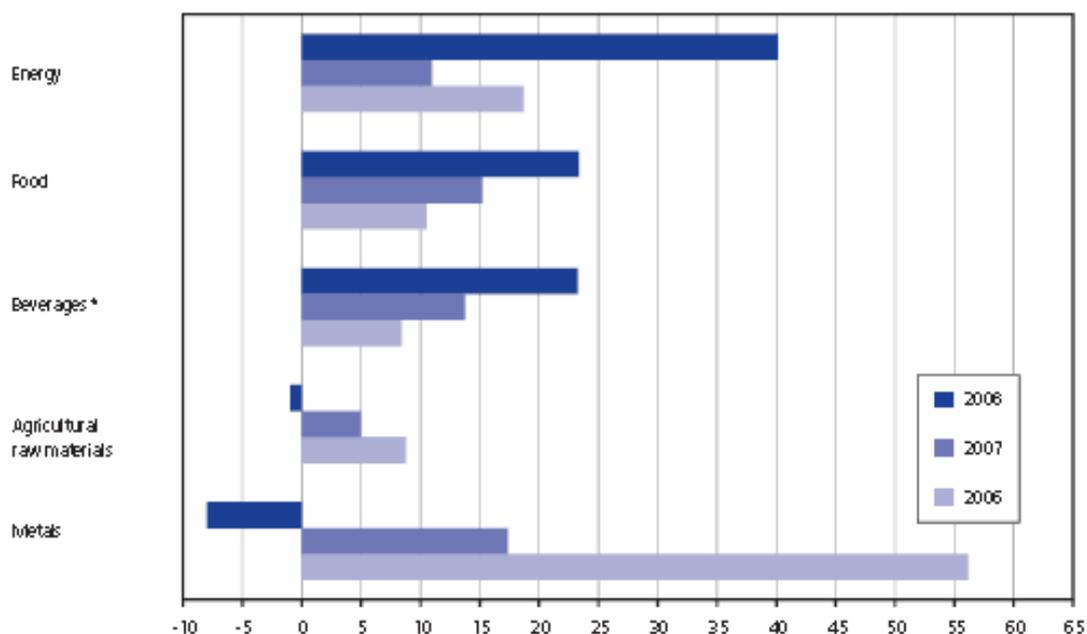
Source: WTO Secretariat.

Export Prices:

Net oil-exporting regions benefited from record fuel prices in 2008, as the cost of a barrel of oil rose to over US\$ 140 by mid-year. Prices declined after July, however, and ended the year below US\$ 50 per barrel, as world demand for oil moderated and the global economy slowed. Energy prices rose 40 per cent on average last year, while prices for food and beverages both increased 23 per cent. Agricultural raw material prices fell by less than 1 per cent, while metals dropped 8.0 per cent.

Export prices of selected primary products, 2006-08

(Annual percentage change)



* Comprising coffee, cocoa beans and tea.

Source: IMF, International Financial Statistics.

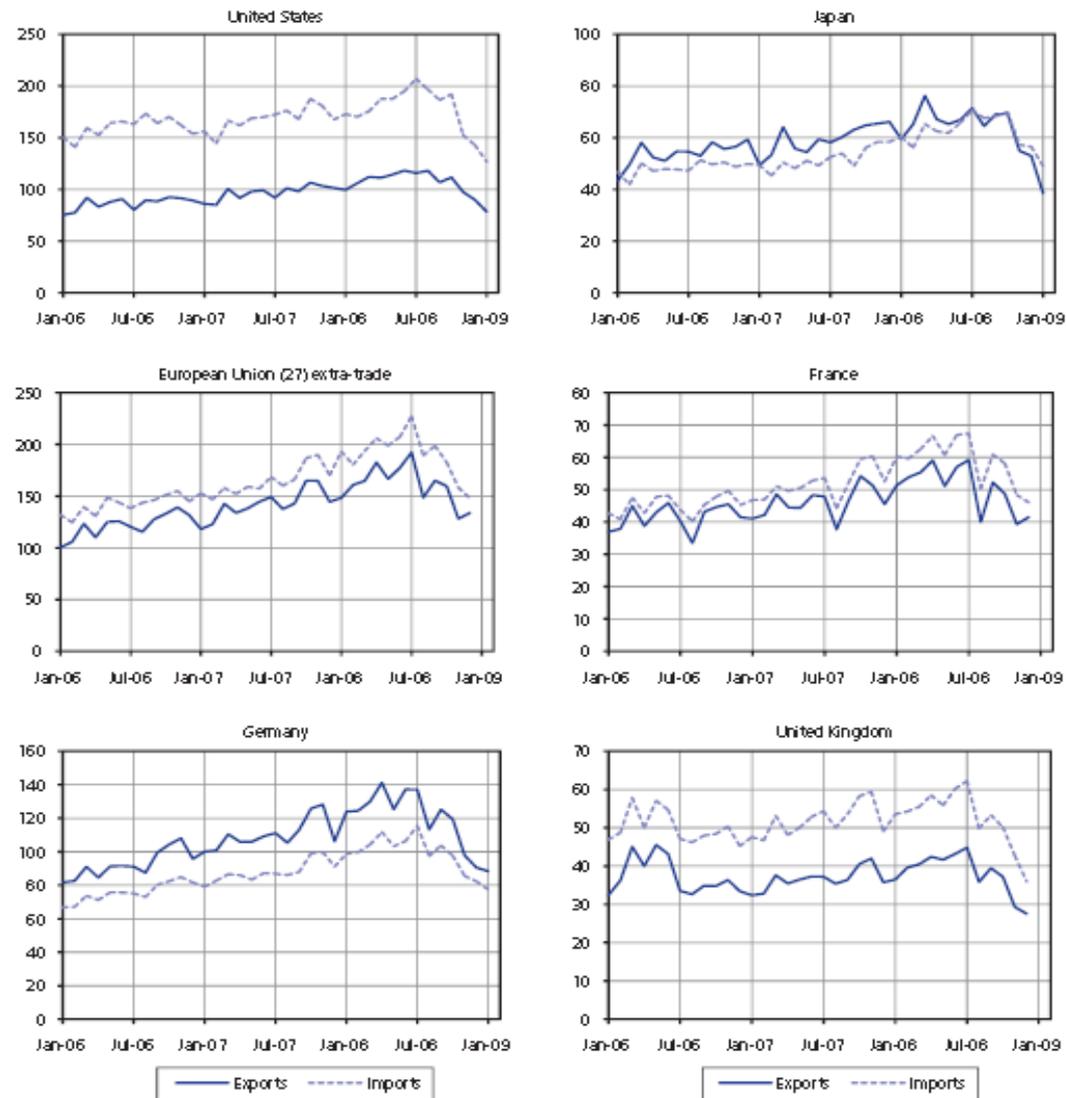
The Financial Crisis and World Trade:

The financial crisis that has so weakened the world economy began in mid-2007 with declines in the values of mortgage-backed securities. This had a severe impact on the balance sheets of major financial institutions. The crisis intensified dramatically following the collapse of the Wall Street investment bank Lehman Brothers in September 2008 and the government-led rescue of a number of financial institutions in the United States and elsewhere.

Turmoil in the financial sector and acute credit shortages spread inexorably to other parts of the economy. Declining asset prices, faltering demand and falling production translated into dramatically reduced and, in some cases, negative growth in production and trade in many countries. Trade has also been affected adversely by a sharp decline in credit to finance imports and exports. Falling stock markets and housing prices have reduced wealth in the United States and elsewhere, making households unwilling to purchase long lasting goods such as cars while they attempt to rebuild their savings. Falling prices for oil and gas, while a boon to consumers in importing countries, have deprived oil-producing countries of export revenues.

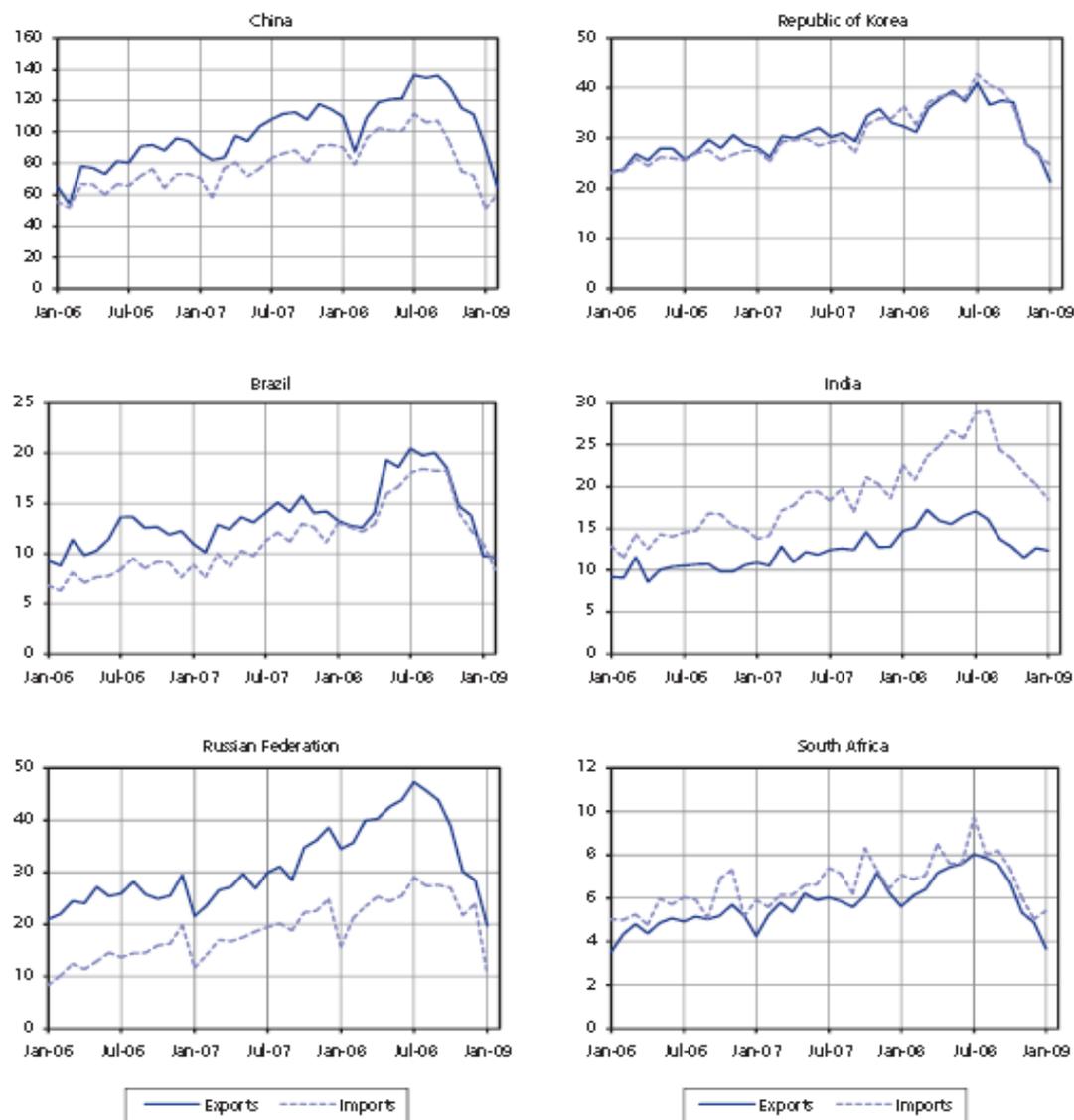
The closing months of 2008 and the start of 2009 saw precipitous drops in global production and trade, first in the developed economies and subsequently in developing countries.

Monthly merchandise exports and imports of selected economies, January 2006-February 2009
(Billion dollars)



Source: IMF International Financial Statistics, Global Trade Information Services GTA database, national statistics.

Monthly merchandise exports and imports of selected economies, January 2006-February 2009
(Billion dollars)



Source: IMF International Financial Statistics, Global Trade Information Services GTA database, national statistics.

Conclusion and References

It can be concluded from the above report that the benefits of international business are immense. International business when undertaken with specific objectives by companies and promoted by governments of nations can lead to overall economic growth of the world at large. Every corporate and government has numerous and concrete reasons to take their business international. Domestic business operations and international business operations have certain similarities, but it is necessary to clearly understand the difference between the two so as to ensure that the international endeavour of any organization is a success. There are different methods of entering foreign markets such as exporting, licensing, franchising, FDI, management contracts and turnkey projects. The choice of method of entry would depend on the long term corporate strategy taking into consideration various environmental factors in the host country and home country. Globalization is the order of the day with most countries eliminating trade barriers and paving the way for growth and expansion of international business. International Business can thus be looked upon as a rescuer which has the potential to lead the world economy out of the woods of the current global downturn.

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