International Business

- Meaning of International Business
- Differences between domestic and foreign business
- Why go international
- Market Entry Strategies
- International Trade Theories
- Free Trade
- Instrument of Trade Policy and Trade Protection
- Economic Integration
- BOP and Terms of Trade

International Trade

- **International trade** refers to buying and selling of goods and services between two or more countries
- **Home trade**: is the process of buying and selling of goods and services between parties within the national boundaries of a country.
- **Foreign and Domestic** trade operate in different environment and are affected by different environmental forces

Differences between Domestic Trade and International Trade

HOME TRADE	FOREIGN TRADE
Conducted within the boundaries of a country	Conducted beyond national boundary of a country
Transaction is carried on with one currency	Transaction is carried on in convertible currencies
There are no restrictions in the movement of goods/factors of labour	There are restrictions to movement of specific goods to specific countries
Documents used are relatively simple	documents used are often complex
Insurance of goods are optional	Insurance of goods are often compulsory
Its market is limited and often sell in small lots	It has a broader market and often sells in large quantities

Why International Trade

- To gain access to new customers
- To achieve lower cost and enhance the firm’s competitiveness
- To capitalize on its core competencies
- To spread its business risk across a wider market
- To protect domestic market
- Boosts economic growth
- Expands markets
- More efficient production systems

Demerits of International Trade

1. Language barriers
2. Socio-cultural issues-Taste and preferences
3. Environmental issues-Rules and regulations
4. Political risk-Political instability
5. Foreign exchange risk

How to enter and compete in foreign Market

- Maintain a **national (one country) production base and export goods** to foreign markets, using either company-owned or foreign-controlled forward distribution channels
- **License** foreign firms to use the company's technology or to produce and distribute the company's product.
- Employ a **franchising** strategy

How to enter and compete in foreign Market

- Follow **global strategy**
- Follow a **multi-country**/**multi-domestic strategy**, varying the country's strategic approach from country to country in accordance with local conditions and differing buyer tastes and preferences.
- Use **strategic alliances** or joint ventures with foreign companies as the primary vehicle for entering foreign markets and perhaps also using them as an on-going strategic arrangement aimed at maintaining or strengthening its competitiveness.

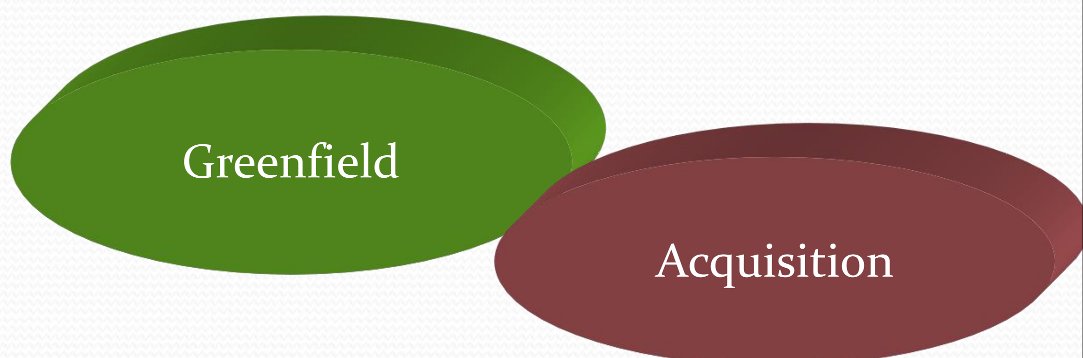
Exporting

Exporting

- Advantages:
  - Avoids cost of establishing manufacturing operations.
  - May help achieve experience curve and location economies.
- Disadvantages:
  - May compete with low-cost location manufacturers.
  - Possible high transportation costs.
  - Tariff barriers.
  - Possible lack of control over marketing representatives.

Wholly Owned Subsidiary

- Advantages:
  - No risk of losing technical competence to a competitor.
  - Tight control of operations.
  - Realize learning curve and location economies.
- Disadvantage:
  - Bear full cost and risk.



Licensing

It is an agreement where the licensor grants rights to intangible property to a licensee for a specified period in return for royalties

- **Advantages:**
  - Reduces development costs and risks of establishing foreign enterprise.
    - *Lack capital for venture.*
    - *Unfamiliar or politically volatile market.*
  - Overcomes restrictive investment barriers.
  - Others can develop business applications of intangible property.
- **Disadvantages:**
  - Lack of control.
  - Cross-border licensing may be difficult.
  - Creating a competitor

Franchising

It is an agreement where the franchisor sells intangible property and insist on strict adherence on the rules for operating business.

- **Advantages:**
  - Reduces costs and risk of establishing enterprise.
- **Disadvantages:**
  - May prohibit movement of profits from one country to support operations in another country.
  - Quality control.

Joint Venture

- **Advantages:**
  - Benefit from local partner's knowledge.
  - Shared costs/risks with partner.
  - Reduced political risk.
- **Disadvantages:**
  - Risk giving control of technology to partner.
  - May not realize experience curve effects/benefits.
  - Shared ownership can lead to conflict.

Strategic Alliance

Cooperative agreements between potential or actual competitors.

- **Advantages:**
  - Facilitate entry into market.
  - Share fixed costs.
  - Bring together skills and assets that neither company has or can develop.
  - Establish industry technology standards.
- **Disadvantage:**
  - Competitors get low cost route to technology and markets.
  - Problems of partner selection

Turnkey Projects

Contractor agrees to handle every detail of project for foreign client.

- **Advantages:**
  - Can earn a return on knowledge asset.
  - Less risky than conventional FDI.
- **Disadvantages:**
  - No long-term interest in the foreign country.
  - May create a competitor.
  - Selling process technology may be selling competitive advantage as well.

International Trade Theories

These theories helps to understand, explain and predict what nations exports and imports with what other nations.

International Trade Theories

- **Mercantilism**: it states that the power and strength of a nation increases as the **wealth** of the nation increases.
- Thus, Nations should accumulate wealth through exports(inflow) and discourage imports
- The trade policy **implication** was the generation of national trade surplus paid for by accumulation of gold reserves
- This was accomplished through trade surpluses, government intervention and colonization.

International Trade Theories

Absolute Cost Advantage Theory: Absolute Cost Advantage refers to a nation's ability to produce more of a good than other nation's using the same amount of resources. Or a country has an absolute advantage in the production of a product when it is more efficient and cheaper in producing it than any other country.

It was propounded by Adams Smith. Smith(1776) made the following propositions:

1. It was impossible for all nations to become rich simultaneously
2. Wealth of Nations depends upon the goods and services available to their citizens rather than their gold reserves

He was a strong advocate of free trade

International Trade Theories

Absolute Cost Advantage

It differs from the mercantilism in that:

1. It measures a nation's wealth by the living standards of its people
2. It destroys the Mercantilist idea since there are gains to be had by both countries to the exchange
3. It challenges the objective of the national government to acquire wealth through restrictive trade policies

Assumptions

Assumptions of Absolute Cost Advantage

- No opportunity cost
- Only two countries
- Only two goods involved
- No barrier to labor mobility
- No transportation costs
- No other barriers of trade such as tariffs and quotas

International Trade Theories

Comparative Advantage

- David Ricardo (1817) developed this theory
- A country enjoys a ***comparative advantage*** in the production of a good if that good can be produced at a lower cost *in terms of other goods*.
- Countries have advantage in a good if it has a lower opportunity cost of producing the good than others

International Trade Theories

Comparative Advantage

Question: Suppose one country is more efficient than another in everything?

- There are still global gains to be made if a country specializes in products it produces relatively more efficiently than other products

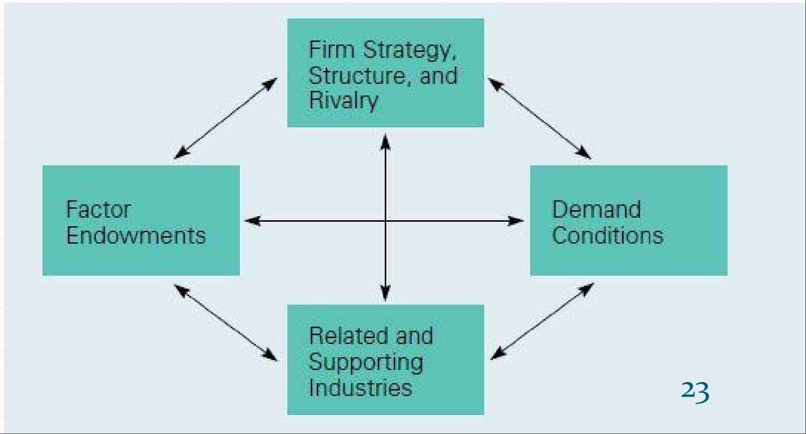
International Trade Theories

Heckscher-Ohlin Theory: It holds that countries must export goods that intensively use factor endowment which are locally abundant while importing goods that make intensive use of factors that are locally scarce.

Patterns of trade are determined by differences in factor endowments.

International Trade Theories

Porter National Competitive Advantage: this theory was developed by Porter(1990). It is commonly referred as Porter's diamond. The tenant of this theory was to explain why a nation achieves international success in a particular industry. E.g. Switzerland excels in Pharmaceuticals, German in Automobiles, US in chemical industry



International Trade Theories

- ***Factor endowments***: a nation's position in factors of production are necessary to determine what they should produce and how to compete in a given industry.
- ***Demand conditions***: the nature and sophistication of home demand for the industry's product or service is critical for its ongoing innovation thereby creating competitive advantage.
- ***Relating and supporting industries***: the presence of strong, efficient supporting and related industries are crucial for gaining international competitiveness.
- ***Firm strategy, structure, and rivalry***: the conditions governing how companies are created, organized, and managed and the nature of domestic rivalry can affect a firms competitiveness .

International Trade Theories

Trade implications of Porters diamond:

- Firms are most likely to succeed in industries or industry segments where the diamond is most favorable.
- The diamond is a mutually reinforcing system. The effect of one attribute is contingent on the state of others. For example, favorable demand condition is required to make factor endowments useful for competitive advantage.

Free Trade

- **Free trade** refers to a situation where a government does not attempt to restrict what its citizens can buy from another country or what they can sell to another country.

- While many nations are nominally committed to free trade, they tend to intervene in international trade to protect the interests of politically important groups

Advantages of Free Trade

- Benefits to Consumers- Greater variety of goods available for consumption.
- Increased production
- Efficiency in production
- Employment
- Foreign exchange gains
- Economic growth

Disadvantages of Free Trade

1. It destroys infant industries
2. It promotes dumping
3. It may leads to unemployment

Instruments of Trade Policy

There are seven main instruments of trade policy

1. Tariffs
2. Subsidies
3. Import quotas
4. Voluntary export restraints
5. Local content requirements
6. Anti-dumping policies
7. Administrative policies

Tariffs

- A tariff is a tax levied on imports that effectively raises the cost of imported products relative to domestic products
  - Specific tariffs are levied as a fixed charge for each unit of a good imported
  - Ad valorem tariffs are levied as a proportion of the value of the imported good

Tariffs

Why do governments impose tariffs?

- Tariffs
  - increase government revenues
  - provide protection to domestic producers against foreign competitors by increasing the cost of imported foreign goods
  - force consumers to pay more for certain imports
- So, tariffs are unambiguously pro-producer and anti-consumer, and tariffs reduce the overall efficiency of the world economy

Subsidies

- A subsidy is a government payment to a domestic producer
- Subsidies help domestic producers
  - compete against low-cost foreign imports
  - gain export markets

Import quotas and voluntary Export Restrictions

- An import quota is a direct restriction on the quantity of some good that may be imported into a country

- Tariff rate quotas are a hybrid of a quota and a tariff where a lower tariff is applied to imports within the quota than to those over the quota

- Voluntary export restraints are quotas on trade imposed by the exporting country, typically at the request of the importing country's government

Local Content Requirements

- A local content requirement demands that some specific fraction of a good be produced domestically
  - The requirement can be in physical terms or in value terms
- Local content requirements benefit domestic producers and jobs, but consumers face higher prices.

Administrative Policies

- Administrative trade polices are bureaucratic rules that are designed to make it difficult for imports to enter a country.
- These polices hurt consumers by denying access to possibly superior foreign products.

Dumping

- Dumping is selling goods in a foreign market below their cost of production, or selling goods in a foreign market at below their “fair” market value.
- It can be a way for firms to unload excess production in foreign markets
- Some dumping may be predatory behaviour, with producers using substantial profits from their home markets to subsidize prices in a foreign market with a view to driving indigenous competitors out of that market, and later raising prices and earning substantial profits

Anti-Dumping Policies

- Antidumping polices are designed to punish foreign firms that engage in dumping
- The goal is to protect domestic producers from "unfair" foreign competition

The Case for Trade Protection

1. Protection saves jobs
2. As a defense against unfair trade practices
3. Cheap foreign labour makes competition unfair
4. Protection safeguards national security
5. Protection discourages dependency
6. Protection safeguards infant and sunset industries
7. As a means to retaliate
8. To help the balance of payment

International Institutions and Agreement

- **International Monetary Fund (IMF):** it mission is to provide exchange rate stability, encourage cooperation on international monetary issues, systems of payments while providing short loans to member countries
- **World Trade Organization (WTO):** it aims to foster free trade by eliminating discrimination in international trade, reducing barrier and tariffs
- **United Nations Conference on Trade and Devt (UNCTAD):** it acted as a pressure group for the less rich countries to influence other trade groups to provide special and favourable terms for underprivileged economies

International Institutions and Agreement

- **Organization for Economic Cooperation and Devt. (OECD):** it was commonly regarded as the rich man's club. It was formed out of the cold war as economic response to the then eastern bloc.
- **International Bank for Reconstruction and Devt. (IBRD)**: it is now referred as the World Bank. It was formed after the world war II to provide economic aid for the rebuilding of Europe and far East. It recent mission is to build the economies of developing countires

Balance of Payment

- The **balance of payments** is the difference between money coming into a country (from exports) and money leaving the country (for imports) plus money coming into or leaving a country from other factors such as tourism, foreign aid, military expenditures, and foreign investment.
- The goal is always to have more money flowing into the country than flowing out.
- A favourable balance of payments means more money flowing into a country than flowing out.
- An unfavourable balance of payments is when more money is flowing out of a country than coming in.

Balance of Payments Accounts

- The **balance of payments accounts** are those that record all transactions between the residents of a country and residents of all foreign nations.
- The balance of payment accounts are separated into 3 broad accounts:
  - **current account**: accounts for flows of goods and services (imports and exports).
  - **financial account**: accounts for flows of financial assets (financial capital).
  - **capital account**: flows of special categories of assets (capital), typically non-market, non-produced, or intangible assets like debt forgiveness, copyrights and trademarks.

Factors which cause a current account deficit in the BOP

1. Fixed exchange rate-If a country's currency is overvalued, imports would be cheaper and exports would be uneconomical.
2. Higher Inflation-This makes exports less competitive and imports more competitive.
3. Decline in competiveness of local firms vis a vis foreign firms. E.g. Ghanaian versus Chinese firms.
4. Recession in trading partners' countries.
5. Borrowing money: Excessive borrowing that have not been channeled to productive investments.

Means of Correcting BOP deficits

1. Restricting home trade to foreigners
2. Building an import substitute industries
3. Devaluing of currency
4. Adopting deflationary policies
5. Financing projects from IGF by government rather than borrowing
6. Instituting intensive drive by granting export bonus and tax holidays

Balance of Trade

- The balance of trade is the difference between the monetary value of exports and imports of output in an economy over a certain period.
- A favourable balance of trade is known as a trade surplus and consists of exporting more than is imported.
- An unfavourable balance is known as trade deficit.

Terms of Trade

- Terms of trade is the relationship between the prices of a country's export and the prices of her imports.
- Terms of trade can be favourable or unfavourable.
- Favourable terms of trade occurs if country concerned can now obtain more imports with the same amount of exports than previously.