Plus One Business Studies Notes

Chapter 11

International Business – I

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International or external business can be defined as those business activities that take place beyond the geographical boundaries of a country. In other words buying and selling of goods and services between two countries are called external trade.

It involves not only the international movements of goods and services but also of capital, personnel, technology and intellectual property like patents, trademarks, know-how and copyrights.

Reasons for international business:

1. Because of the unequal distribution of natural resources and differences in productivity levels, a country cannot produce all that they need

2. Labour productivity and production costs differ among nations due to various socio-economic, geographical and political reasons.

3. Availability of various factors of production such as labour, capital and raw materials differ among nations.

Differences between International Business and Domestic Business:

Domestic Business	International Business.
Both the buyers and sellers are from the same country	Buyers and sellers are from different Countries
Various stakeholders such as suppliers, employees, middlemen .shareholders and partners are usually citizens of the same country	Various stakeholders such as suppliers, employees, middlemen, shareholders and partners are from different nations
The factors of production Like capital, labour and raw material can move freely within the country	There are, restrictions on free mobility of factors of production across countries
Domestic markets are relative more homogeneous in nature	International markets lack homogeneity due to differences, in languages, preferences customs etc across markets.
Business systems and practices are relatively more homogeneous within a country	Business systems and practices vary considerably across countries.
It has to face the political system and risk of only one country	Different countries have different forms of political systems and risk.
Business laws, regulations and economic policies are uniformly applicable within a country.	Business laws, regulations and economic policies are differ widely among nations.
Currency of domestic country is used.	They use different currencies for business transactions.

Scope of International Business:

1. Merchandise exports and imports:
merchandise exports means sending tangible goods abroad, merchandise imports means bringing tangible goods from a foreign country to one's own country. It is also known as trade in goods (visible trade), include only tangible goods and exclude services.

2. Service exports and imports:
It involves trade in intangibles. It is also known as invisible trade which includes services received from other countries or services rendered to other countries. eg: Tourism and travel, communication, marketing, transportation services etc.

3. Licensing and franchising:
Permitting another party in a foreign country to produce and sell goods under their trademarks, patents or copyright in lieu of some fee is called licensing. Franchising is similar to licensing, but it is a term used in connection with the provision of services.

4. Foreign investments:
Foreign investment involves investments of funds abroad in exchange for financial return. Foreign investment can be of two types.
(a) Direct investments:
Direct investment takes place when a company directly invests in properties such as plant and machinery in foreign countries with a view to undertaking production and marketing of

goods and services in those countries. This is also known as Foreign Direct Investment, i.e., FDI.

(b) Portfolio investment:
Under portfolio investment, a company makes investment by acquiring shares or providing loans to a foreign company and earns income by way of dividends or interest on loans.

In this investor does not get directly involved in production or marketing of goods. It simply earns an income by investing in shares, bonds, bills, or notes in a foreign country or providing loans to foreign business firms.

Benefits of International Business:
The benefits of international business to the nations and business firms are.
Benefits to Nations:
1. Earning of foreign exchange:
It helps a country team foreign exchange which can be used for importing capital goods, technology, petroleum products and fertilisers, pharmaceutical products, etc.

2. More efficient use of resources:
External trade enables a country to utilize the available resources in the best possible manner.

3. Improving growth prospects and employment potentials:
External trade helps to accelerate the economic growth and employment opportunities of a country.

4. Increased standard of living:
Foreign trade helps in raising the standard of living of a country.

5. International relation:
External trade helps to promote harmonious and cordial relationship among the nations.

Benefits to Firms:
1. Prospects for higher profits:
When the domestic prices are lower, business firms can earn more profits by selling their products in countries where prices are high.

2. Increased capacity utilisation:
It help firms in using their surplus production capacities and improving the profitability of their operations. Large scale production helps to reduce the cost of production.

3. Prospects for growth:
It helps firms in improving their growth prospects by creating demands for their products in foreign countries.

4. Enhances competition:
External trade enhances competition, which compels the domestic firms to improve technology of production, production process and quality of the products.

5. Improved business vision:
It improves business vision as it makes firms to grow, more competitive and diversified.

Mode of Entry into International Business:

1. Exporting and Importing:
When goods are sold to a foreign country, it is called export trade. When goods are purchasing from a foreign country, it is called import trade.
Advantages:

- It is the easiest way of gaining entry into international markets.
- Business firms are not required to invest that much time and money in host countries.
- It is less risky as compared to other modes of entry into international business

Limitations:

- It involves additional packaging, transportation and insurance costs.
- Exporting is not possible in case the foreign country restricts imports.
- The export firms do not have much contact with the foreign markets.

2. Contract Manufacturing (Outsourcing):
When a firm enters into a contract with one or a few local manufacturers in foreign countries to get certain goods produced as per its specifications it is called contract manufacturing. It is also known as outsourcing and it can take place in the following forms.

- Production of certain components
- Assembly of components into final products

- Complete manufacture of the products

Advantages:

- It Permits international firms to get the goods produced on a large scale without requiring investment in setting up production facilities.

- There is no investment risk involved in foreign countries.

- It helps to get the products at a lower cost

- Local producers in foreign countries can ensure greater utilization of their idle production capacities.

Limitations:
(a) It may affect the quality of the products.

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

(c) The local firm cannot sell the contracted output as per their will.

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

Franchising is similar to licensing. But it is used in connection with the provision of services. The parent company is called the franchiser and the other party to the agreement is called the franchisee.
Advantages:

1. It is a less expensive mode of entering into international business.

2. There is no investment risk

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

4. Since the licensee/franchisee is a local person, he has the greater market knowledge and customer contacts. It helps the licensor/franchiser in successfully conducting its marketing operations.

Limitations:
(a) The licensee can start marketing an identical product under a slightly different brand name.

(b) Trade secrets may lose in the foreign markets.

(c) Conflicts often develop between the licensor/franchiser and licensee/franchisee oyer issues such as maintenance of accounts, payment of royalty, etc.

4. Joint Ventures:
Joint venture means establishing a firm that is jointly owned by two or more independent firms. It can be brought into existence in three major ways.

- •Foreign investor buying an interest in a local firm.
- •Local firm acquiring an interest in an existing foreign firm.
- •Both the foreign and local entrepreneurs jointly forming a new enterprise

Advantages:

1.Since the local partner also contributes to the equity capital, the international firm has less financial burden to expand the business globally.

2.It helps to execute large projects requiring huge capital outlays and manpower.

3.The foreign business firm benefits from local partner's knowledge of the host countries.

4.The foreign business firm shares cost and risks with local partner. So they can enter into foreign market very easily and without high risk.

Limitations:

1.Foreign firms entering into joint ventures share the technology and trade secrets with local firms. It leads to leakage of technology and secrets to others.

2.The dual ownership arrangement may lead to conflicts

5. Wholly Owned Subsidiaries:
The parent company (holding company) acquires full control over the foreign company by making 100% investment in its equity capital. It is called wholly-owned subsidiaries. It can be established in either of the two ways. i.e.

•Setting up a new firm altogether to start operations in a foreign country

•Acquiring an existing firm in the foreign country

Advantages:

1.The parent firm is able to exercise full control over its operations in foreign countries.

2.It is not required to disclose its technology or trade secrets to others.

Limitations:

1.It is not suitable for small and medium-size firms which do not have enough funds to invest abroad.

2.The parent company alone has to bear the entire loss.

3.It is subject to higher political risk.