UNIT VIII INTERNATIONAL BUSINESS

CHAPTER 25 INTERNATIONAL BUSINESS

Learning Objectives

To enable the students to

i. explain the meaning of international business

ii. state as to why international business takes place and how does it differ from internal trade

iii. describe the scope and benefits of international trade

iv. discuss the different types of international trade

Introduction

The previous chapter deals with internal trade and various types of internal trade in detail. The present chapter presents the basic aspects of international business. It enlightens the students on the difference between internal trade and international business, types of international business, the advantages and disadvantages of international business. Let us first shed light on the meaning and definition of international business. India's international trade is not of recent origin. The various pieces of literature bear enormous evidence about India's foreign trade with other countries. Evidences about our international trade are found in the ancient literature of our country particularly in our Sangam Literature. There were regular Trade Routes across the seas to the distant Jawa and Sumatra islands in the east and up to the Arabian Peninsula in the west. But the volume of such trade was insignificant and continued to remain so small all through the middle ages and right up to the advent of the British rule in India. It is only after the establishment of the British rule in India that India's foreign trade took a definite shape.

DO YOU KNOW?

There are some routes of International Business before 18th century 1. Salt Route-India to Egypt 2.Silk Route-China to India 3.Spice Route-India to Europe

International trade has become inevitable after the second world war since no country remains self sufficient in terms of all natural resources available therein. In other words no country is currently functioning independently as a closed system. Even the socialistic countries like U.S.S.R. China, etc., are now taking concrete steps to capture foreign markets for the product abundantly produced in their countries. International trade has become a part and parcel of our normal economic life of any country.

Chola and Foreign Trade

The Cholas excelled in foreign trade and maritime activity, They extended their influence overseas to China and Southeast Asia.Towards the end of the 9th century, Southern India had developed vast extensive maritime and commercial activity. The South Indian guilds played a major role in interregional and overseas trade. The best known of these were the Manigramam and Ayyavole guilds. The encouragement given by the Chola court gave impetus to the expansion of Tamil Merchant Associations such as the Ayyavole and Manigramam guilds in Southeast Asia and China. The Cholas, being in possession of ports of both the west and the east coast of peninsular India, were at the forefront of these ventures.

25.01 Nature of International Business

Countries across the world are endowed with natural resources of various kinds. But no single country uniquely possesses all natural resources required for its people. Due to varying climatic conditions prevailing across the world certain resources are abundantly available in some countries, while these resources may not exist or may not be available to the required extent in other parts of the countries. This situation paves way for international business. In other words countries with surplus resources have to exchange them with other countries for its deficit resources. For example, Gulf countries are super rich in petroleum resources but they do not have any other essential resources needed for human existence. Hence they have to exchange the surplus petroleum resources to buy other essential resources from other countries where they are available abundantly.

Similarly some advanced countries produce goods and services of good quality at affordable prices using sophisticated techniques. The developing countries and least developed countries cannot afford to produce those goods with their limited technical knowhow. In such a case international business enables these countries to buy those goods from advanced countries. This makes it necessary for international business

In short uneven distribution of natural resources across the world and specialisation attained by certain countries in the production of certain products push those countries to exchange goods and services with one another. This exchange a warrants International trade or International business.

Today we live in a world where the obstacles to the exchange of the goods and technology have been substantially reduced. Due to advancement of technology the national economies are increasingly becoming borderless and getting progressively integrated into the world economy. The contemporary world is called as 'global village'. Business in today's context is not restricted to the mere boundaries of the country but also expands to boundaries of the several other countries. Due to tremendous development in the information and communication technology (ICT) and rapid advancement in transportational system more and more firms engage in international business which presents them with numerous opportunities for their faster economic growth and increased gains.

India has been trading with other countries fairly for a long period of time. It has played a vital role in international business from the ancient period. But it has of late considerably speeded up the process of integrating with the world economy and phenomenally increased its foreign trade and investments.

25.02 Concept, Meaning and Definition of International Business

Concept of International Business

Today business is growing globally and the need for profit is pushing a large number of business firms into world markets beyond their historical and traditional boundaries. A global corporation is gaining an increasing acceptance in the business community compared to corporations operating within the geographical limits of a country. These companies are termed as Multi National Corporations (MNC) or Trans National Company(TNC). These companies operate on the principle that the world is their field of operations. For example. Shell, Unilever, Nestle, etc., operate on the philosophy of "global corporation". They cannot be labeled as French or German or Dutch or Swiss company. These companies have no real domestic market. People of many different nationalities are managing and operating these corporations on a day to day basis. Their products and services are sold around the world through their operating subsidiaries functioning in various countries.

International business involves transactions across the national boundaries. It includes the transfer of goods, services, technology, managerial knowledge and capital to other countries. Although business has been conducted on an international scale for many years, international business has gained more significance only in recent years because of the emergence of multinational corporations in some of the developing countries.

Meaning

International business denotes all those business activities which take place beyond the geographical limits of the country. 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 copy rights.

Definition

Roger Bennet defines, International business involves commercial activities that cross national frontiers

According to John D. Daniels and Lee H. Radebaugh, International business

India embarks on the path to Globalisation

International business has entered into a new era of reforms. India too did not remain cut-off from these developments. India was under severe debt trap and was facing crippling balance of payments crisis. In 1991, it approached the International Monetary Fund (IMF) for raising funds to tide over its balance of payment deficit. IMF agreed to lend money to India subjects to the conditions that India would undergo structural changes to be able to ensure repayment of borrowed fund. India had no alternative but to agree to the proposal. It was the conditions imposed by IMF which more or less force India to liberalise its economic policies. Since then a fairly large amount of liberalization at the economic front has taken place. Though the process of reforms has somewhat slowed down. India is very much on the path to globalization and integrating with world economy. While, on the one hand, many multinational corporations (MNCs) have ventured into Indian market for selling their goods and services, many Indian companies too have stepped out the country to market their goods and services to consumers in foreign countries

is all business transactions-private and governmental- that involve two or more countries. Private companies undertake such transactions for profits, governments may or may not do the same in their transactions.

25.03 Method of Conducting International Business

1. Exporting and Importing

Exporting denotes selling of goods and services from the home country to a foreign country. Similarly importing refers to purchasing of products from foreign country and bringing them into home country

2. Contract Manufacturing (or) Outsourcing

It connotes a type of international business where a firm enters into a contract with one or a few local manufacturers in foreign countries in order to get certain components of goods produced according to its specifications. It is also called outsourcing or contract manufacturing

3. Licensing and Franchising

Licensing is contractual agreement wherein one firm grants access to its plants, trade secrets or technology to another firm in a foreign country, for a fee called royalty, e.g. McDonald, Pisa Hut, etc., The firm which grants such permission is called Licensor or Franchisor and other firm to whom the license is granted is called Licensee or Franchisee

4. Joint Venture

A Joint venture is a business agreement wherein parties agree to develop a new entity and assets subscribing to equity shares and thereby exercising control over enterprise and consequently sharing revenues, expenses and the assets. It can be established under three different ways namely

(i) Foreign Investors buying an interest in local company

(ii) Local firm acquiring an interest in the existing foreign firm

(iii) Both the foreign and local firms jointly forming a new enterprise.

25.04 Features of International Business

The following are the features of international business

(a) Involvement of Countries.

International business can take place only when transactions occur across different countries

(b) Use of Foreign Exchange.

Where countries trade with one another, it has to exchange the goods and services on the basis of foreign currency.

(c) Legal Obligations.

Foreign trade is to be conducted strictly in accordance with the export and import policy of the country concerned. The consent of the government is to be mandatorily obtained with reference to export and import of certain goods and services. Thus government intervention is direct in respect of international transactions.

(d) Heavy Documentation Work.

International business necessitates fulfillment of a lot of formalities. Parties to international business have to execute a number of documents in the matters of conducting International business.

(e) Difference in Economic Environment.

The economic environment of countries involved in international business differs significantly in terms of legal framework, institutional set-up, monetary fiscal and commercial policy, resources availability, production techniques, etc.,

25.05 Rationale Behind International Business

i. Unequal Distribution of Natural Resources.

Countries across the world are not endowed with the natural resources of various types equally and equitably. In other words, the natural resources are unevenly spread across the various nations. As a result the countries having surplus resources have to exchange it for those resources which are not available in their home country. This uneven distribution of resources worldwide makes it necessary the exchange of goods among the countries through international business.

ii. Uneven Availability of Factors of Production.

The availability of various factors of production namely, land, labour, capital and technology for producing goods and services differ among different countries. International business moves the surplus factor in one country over to another country where it is in short supply. Therefore international business is necessary.

iii. Specialisation.

Certain countries or some geographical areas of a certain country specialize in the production of goods and services due to some natural advantages like abundant availability of skilled labour, favorable climatic conditions, availability of natural resources, technical know-how, etc., For example, In India Coimbatore specilises in cotton textiles and producing textiles and machinery; Tirupur specialises in manufacturing hosiery products This specialisation paves way for large scale production of specialised items. International business transfers the abundant surplus to other countries which do not have these specialised goods or products

iv. Cost Benefit.

Production cost varies significantly among the countries due to difference in socio-economic, geographical, demographical, technical and political environments prevailing therein. As a result some countries are in a better position to produce some goods more economically and efficiently than other countries. This makes the firms engaged in international business import the goods available at lower prices from other countries and export the goods which bring them better prices to other countries.

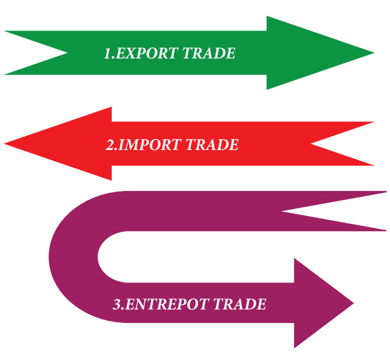
25.06 Differences Between Domestic Business and International Business

Basis	Domestic Business	International Business
1. Meaning	Domestic business refers to business transactions transacted within the geographical boundaries of a country	International business refers to the business transactions transacted in beyond the boundaries of a country
2. Participants in Business	People / organizations within the country participate in business activities	People/organizations outside the country participate in business activities
3. Mobility of Factor of Production	The factors of production i.e. labour,, capital, technology, material, etc., move freely within the boundaries of the country	The factors of production i.e. labour,, capital, technology, material, etc., move across the boundaries of the country.
4. Nature of Consumers	Consumers are relatively homogenous in nature in terms of culture, behavior ,taste, preferences, legal system, customs and practices, etc.,	Consumers are relatively heterogeneous in nature in terms of culture, behavior ,taste, preferences, legal system, customs and practices, etc. prevailing across the countries,
5. Business System	Domestic business is governed by the rules, laws, policies taxation system of a single country	International business is governed by rules, laws and policies ,tariffs and quotas etc., of multiple countries
6. Currency Used	Domestic business transactions are settled by local currency of a country.	International business transactions are settled by foreign currencies.

7. Mode of Transport	The goods involved in domestic business are mainly transported by roadways and railways.	The goods involved in international business is mainly transported by water and airways.
8. Risk Exposure	The risks involved in domestic business are relatively less.	The risks involved in international business are more due to distance, difference in socio-economic and political conditions. change in foreign exchanges value, etc.,
9. Scope of Market	The scope of market is limited to national boundaries of a country.	The scope of international business is very wide and extends beyond the frontiers of a country.
10. Payment of Excise duty	Payment of excise duty involves simple procedures and it is relatively low in domestic trade	The process of payment of excise is complicated in international business and the rate of excise duty is relatively high.

25.07 Types of International Business

On the basis of sale and purchase of goods and services, international trade can be divided into three kinds. They are export trade, import trade and entrepot trade. It has been exhibited in the chart drawn below



These trades are briefly stated hereunder

A) Export Trade

When the firm of country sells goods and services to a firm of another country it is called export trade. Export trade indicates selling of goods and services from the home country to a foreign country. For Example; the sale of handicraft, leather products, electronic goods, herbal products, etc., by Indian company to other countries is known as export trade.

B) Import Trade

When the business firm of a country purchases goods from the firm of another country it is called import trade. Importing means purchase of foreign products and bringing them into one's home country. For example when Indian enterprise purchases petroleum products, electrical goods, machinery, and medical equipments etc., from other countries, it is termed as Import Trade

C) Entrepot Trade

When the firm of country imports goods for the purpose of exporting the same goods to the firms of some other country with or without making any change in the goods meant for export it is known as entrepot trade

For example, If an Indian company imports crude oil from Iran and exports it as petroleum after refining it in India, to Nepal it is called Entrepot trade. In this context crude is converted into petrol and exporter as petrol to Nepal

Now you must be thinking why India comes between Iran and Nepal. Why does not Nepal directly import crude oil from Iran?. Let us explore what could be the possible reasons for this.

Neccessity for Entrepot Trade

A country cannot import goods directly from the others because of the following reasons.

a) The country may not have any accessible trade routes connecting the importing country

b) The goods imported may require further processing or finishing before exporting, and these facilities may be lacking in the exporting or importing country

c) There may not have any bilateral trade agreement between both the country

d) Importer and exporter may not share good economic relation with each other

Features of Entrepot Trade

The following are the special features of Entrepot trade

a) Import duty is not levied on such goods

b) These goods are reprocessed and repacked for re- export

c) Such goods are kept in the Bonded warehouse till they are re-exported.

25.08 Advantages and Disadvantages of International Business

Advantages

1. Geographical Specialization

Countries across the world differ significantly in terms of natural resources, capital equipment, manpower, technology and land and so on. Some countries are rich in mineral resources hydro-electric power metallic resources, and so on while some other countries may possess advanced technique of manufacturing, efficient working population, capital equipment and so on. International business is required to exchange the surplus resources resulting from geographical specialisation for deficit resources in other countries

2. Optimum use of Natural Resources

International business operates on a simple principle that a country which can produce more efficiently and trade the surplus production with other countries has to procure what it cannot produce more efficiently. This enables the countries to optimally utilize the scarce resources available with them

3. Economic Development.

International business helps the developing countries greatly in achieving rapid economic development by importing machinery, equipment, technology, talent, and so on. For example., China, India, Brazil and South Korea which were once slower in their economic development are achieving faster economic development due to international business. Even the developed countries like Japan, USA, UK, etc., have achieved remarkable economic progress through the import of raw materials and export of manufactured goods.

4. Generation of Employment.

International business generates employment opportunities by assisting the expansion and growth of agricultural and industrial activities. It provides direct employment to those people who are hired by export and import firms and generates indirect employment to number of intermediary firms like, clearing and forwarding agent, indent houses transport organizations, outsourcing agencies, etc.

5. Higher Standard of Living.

On account of international business, the citizens of the country can buy more varieties of goods and services which cannot be produced cost effectively within the home country. This exchange of goods and services among the countries enhances the standard of living of people.

6. Price Equilisation

International business helps to stabilize the prices of various commodities which are fluctuating on a daily basis in the world market. Whenever the price of a commodity rises sharply in a particular country, the same commodity is imported from some other foreign countries to prevent the sharp rise in prices in the home country. Thus international business prevents violent fluctuations of prices of various commodities and helps maintain prices of various commodities at stable level in each and every country.

7. Prospects for Higher Profit.

International business helps the firms which produce goods in excess to sell them at relatively higher price to various countries in the international market. This enables them to earn higher profit.

8. Capacity Utilisation.

International business enables the firms across the country to sell their goods and services on a large scale in the international market. As a result their machinery and equipments are used to their full capacity. In short very prospect of selling goods in international market besides selling the goods in home market keeps the machineries, tools, equipment, and factory fully engaged all through the year.

9. International Peace.

International business makes countries across the world become inter-dependent while these countries are independent in their functioning. This facilitates the exchange of culture, ideas and mutual understanding. It develops and strengthens cultural and social relations among the people of different countries. All these collectively contribute to maintain international peace.

Disadvantages

1.Economic Dependence.

International trade is more likely to make the country too much dependent on imports from foreign countries. The former may not take any efforts to produce goods and services indigenously to substitute imported goods and thus becoming self sufficient. As a result the importing country may become economically slave to exporting country and end up becoming colony of the exporting country.

2. Inhibition of Growth of Home Industries.

International business may discourage the growth of indigenous industry. Unrestricted imports and severe competition from foreign companies may ruin the home industries altogether.

3. Import of Harmful Goods.

International business may lead to import of luxurious goods, spurious goods, dangerous goods, etc. It may harm the well-being of people.

4. Misuse of Natural Resources.

Excessive export of scarce natural resources to various countries across the world may lead to faster depletion of the resources in the exporting countries. This in turn may bring about ecological disaster in the country from which it is exported.

5. Political Exploitation.

International business may create economic dependence among the countries which may threaten their political independence. The MNCs may influence the policy decision of the government to their favour. In due course of time they may dictate terms to administrators of nation by the sheer strength of their money power. For example Britishers came to many countries as mere traders and ultimately colonized those countries and ruled them for centuries.

6. Rivalry among the Nations.

Acute competition for exports may lead to rivalry among the nations. This may lead to conflict of interest among the countries and end up in wars among them.

7. Invasion of Culture.

International business may result in invasion of country's culture. Younger generation is more likely to imitate foreign culture and buy goods and services beyond their means to gain acceptance in the affluent section of society. This will ruin the conventional lifestyle of the society.

Key Terms

International business
Export Trade
Import Trade
Specialization
Natural resources
Entrepot

For Future Learning

1. Scope of international business
2. Wide range of international business

For Own Thinking

Take interest in export or import trade

Try to become exporter

Exercise

I. Choose the Correct Answer

1. **Movement of goods , services, intellectual property, human assets, technology and so on among the countries.**

   (a) International Trade

   (b) International business

   (c) Entrepot Trade

   (d) Internal trade

2. **Goods are imported for purpose of re-export to another country is termed as__________.**
   (a) Import Trade
   (b) Export Trade
   (c) Entrepot Trade
   (d) International trade

3. **Movement of goods , services among the countries.**
   (a) International Trade
   (b) International business
   (c) Entrepot Trade
   (d) Internal trade

4. **Selling of goods from home country to foreign country is called**
   (a) Home Trade
   (b) Entrepot Trade
   (c) Foreign Trade
   (d) Joint Venture

Answers

1.a 2.c 3.b 4.c

II. Very Short Answer Questions

1. What do you mean by International business?
2. What is meant by Export Trade?
3. What is meant by Import Trade?
4. What is meant by Entrepot Trade?

III. Short Answer Questions

1. Explain any three features of International business.
2. Explain the features of Entrepot trade.

IV. Long Answer Questions

1. List out the advantages of International trade. (any 5)
2. Distinguish between internal and international trade. (any 5)

Reference

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