International Business: An Overview

International Business is all commercial transactions—private and governmental between two or more countries. Private companies undertake such transactions for profit; governments may or may not do the same in their transactions. These transactions include sales, investments and transportation.

Why should you study international business? A simple answer is that international business comprises a large and growing portion of the world’s total business. Today global events and competition affect almost all companies – large or small – because most sell output to and secure supplies from foreign countries. Many companies also compete against products and services that come from abroad.

The conditions within a company’s external environment (the conditions outside a company as opposed to its internal ones) affect the way business functions such as marketing are carried out. These conditions are physical, societal and competitive. When a company operates internationally, it adds foreign conditions to its domestic ones making its external environment more diverse.

Even if you never have direct international business responsibilities, you may find it useful to understand some of its complexities. Companies international operations and governmental regulation of international business affect company profits, employment security and wages, consumer prices and national security. A better understanding of international business may help you to make more informed decisions, such as where you want to work and what governmental policies you want to support.

Today, business is acknowledged to be international and there is a general expectation that this will continue for the foreseeable future. International business may be defined simply as business transactions that take place across national borders. This broad definition includes the very small firm that exports (or imports) a small quantity to only one country, as well as the very large global
firm with integrated operations and strategic alliances around the world. Within this broad array, distinctions are often made among different types of international firms, and these distinctions are helpful in understanding a firm’s strategy, organization, and functional decisions (for example, its financial, administrative, marketing, human resource, or operations decisions).

One distinction that can be helpful is the distinction between multi-domestic operations, with independent subsidiaries which act essentially as domestic firms, and global operations, with integrated subsidiaries which are closely related and interconnected. These may be thought of as the two ends of a continuum, with many possibilities in between. Firms are unlikely to be at one end of the continuum, though, as they often combining aspects of multi-domestic operations with aspects of global operations.

International business grew over the last half of the twentieth century partly because of liberalization of both trade and investment, and partly because doing business internationally had become easier. In terms of liberalization, the General Agreement on Tariffs and Trade (GATT) negotiation rounds resulted in trade liberalization, and this was continued with the formation of the World Trade Organization (WTO) in 1995.

At the same time, worldwide capital movements were liberalized by most governments, particularly with the advent of electronic funds transfers. In addition, the introduction of a new European monetary unit, the euro, into circulation in January 2002 has impacted international business economically. The euro is the currency of the European Union, membership in March 2005 of 25 countries, and the euro replaced each country’s previous currency. As of early 2005, the United States dollar continues to struggle against the euro and the impacts are being felt across industries worldwide.

In terms of ease of doing business internationally, two major forces are important:

- Technological developments which make global communication and transportation relatively quick and convenient; and
- The disappearance of a substantial part of the communist world, opening many of the world’s economies to private business.

**WHY COMPANIES ENGAGE IN INTERNATIONAL BUSINESS**

When operating internationally, a company should consider its **mission** (what it will seek to do and become over the long term), its **objectives** (specific performance targets to fulfill its mission) and **strategy** (the means to fulfill its objectives). There are seven major objectives that may influence companies to engage in international business. They are:

- To expand sales
- To acquire resources
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- To diversify sources of sales and supplies
- To minimize competitive risk
- Profit advantage
- Growth opportunities
- Government policies and regulations

**Expand Sales:** Companies sales are dependent on two factors: the consumers’ interest in their products or services and the consumers’ willingness and ability to buy them. The number of people and the amount of their purchasing power are higher for the world as a whole than for a single country, so companies may increase their sales by reaching international business.

Ordinarily, higher sales means higher profits, assuming each unit sold has the same markup. For example, the *Star Wars* cost millions of dollars to produce, but as more people see the films, the average production cost per viewer decreases.

So, increasing the sales will be major motive for a company’s expansion into international business. Many of the world’s largest companies derive over half their sales from outside their home country. You’ve heard of many of these companies (with their home country in parenthesis) – BASF (Germany), Electrolux (Sweden), Gillette (the United States), Michelin (France), Nestle (Switzerland), Philips (the Netherlands) and Sony (Japan). However, smaller companies also may depend on foreign sales. Many small companies also depend on sales of components to large companies, which in turn put them in finished products that they sell abroad.

**Acquire Resources:** Manufacturers and distributors seek out products, services and components produced in foreign countries. They also look for foreign capital, technologies, and information they can use at home. Acquiring resources may enable a company to improve its product quality and differentiate itself from competitors – in both cases, potentially increasing market share and profits. Although a company may initially use domestic resources to expand abroad, once the foreign operations are in place, the foreign earnings may the serve as resources for domestic operations.

**Diversify Sources of Sales and Supplies:** To minimize swings in sales and profits, companies may seek out foreign markets to take advantage of business cycle—recessions and expansions—differences among countries. Sales decrease in a country that is in a recession and increase in one that is expanding economically. By obtaining supplies of the same product or component from different countries, companies may be able to avoid the full impact of price swings or shortages in any one country.

**Minimize Competitive Risk:** Many companies enter into international business for defensive reasons. They want to counter advantages competitors might
gain in foreign markets that, in turn, could hurt them domestically. For example, Company A and Company B compete in the same domestic market. Company A may fear that Company B will generate large profits from a foreign market if left alone to serve that market. Company B may then use those profits in various ways (such as additional advertising or development of improved products) to improve its competitive position in the domestic market. Companies harboring such a fear may enter foreign markets primarily to prevent a competitor from gaining advantages.

**Profit Advantage:** The international business provides more profit advantage. International business is more profitable than the domestic. When we examine the average unit cost of production, we may find that the average cost of production per unit will be lowest if the plant is operated at optimum capacity. The relative rate of profit per unit will increase when the total profit from domestic business increase.

**Growth Opportunities:** In most of the foreign markets there is a vast growth prospects to attract foreign companies. In many countries, both the population and income are growing fast. Though the market for several goods in many domestic markets is not very substantial at present. So, many companies/countries are eager to establish a foothold in foreign market considering their future potential in mind.

**Government Policies and Regulations:** In developing countries like India, Government policies and regulations do encourage and motivate the exporters to go international. Most of the governments provide a number of incentives and other forms of positive support to domestic companies to export and to invest in foreign market. With the recent changes in the Government of India’s economic policy, now most of the companies are entering international market.

### MODES OF INTERNATIONAL BUSINESS

When pursuing international business, private enterprises and governments have to decide how to carry out their business, such as what mode of operation to use. The topic discusses how a company has a number of modes from which to choose.

### MERCHANDISE EXPORTS AND IMPORTS

Companies may export or import either goods or services. More companies are involved in exporting and importing than in any other international mode. This is especially true of smaller companies, even though they are less likely than large companies to engage in exporting. **Merchandise exports** are tangible products—goods—sent out a country; **merchandise imports** are goods brought in. Because these goods can be seen leaving and entering a country, they are sometimes called **visible exports and imports.** The terms **exports** and **imports**
frequently apply to merchandise, not service. For most countries, exporting and importing of goods are the major sources of international revenue and expenditures.

### SERVICE EXPORTS AND IMPORTS

**Service exports and imports** are non-product international earnings. The company or individual receiving payment is making a *service export*. The company or individual paying is making a *service import*. Service exports and imports take many forms. In this section, we discuss the following sources of such earnings:

- Tourism and transportation
- Performance of services
- Use of assets

**Tourism and Transportation**: International tourism and transportation are important sources of revenue for airlines, shipping companies, travel agencies and hotels. Some countries’ economies, too, depend heavily on revenue from these economic sectors. For example, in Greece and Norway, a significant amount of employment, profits, and foreign exchange comes from foreign cargo that is carried on ships owned by citizens of these countries. Earnings from foreign tourism are more important for the Bahamian economy than are earnings from the export of merchandise.

**Performance of Services**: Some services—banking, insurance, rentals (such as of *Star Wars* films), engineering, management services and so on – net companies earnings in the form of fees, that is, payments for the performance of those services. On an international level, for example, companies pay fees for engineering services that are often handled through **turnkey operations** – construction, performed under contract, of facilities that are transferred to the owner when they are ready to begin operating. Companies also pay fees for **management contracts** – arrangements in which one company provides personnel to perform general or specialized management functions for another company.

**Use of Assets**: When companies allow others to use their assets, such as trademarks, patents, copyrights, or expertise under contracts, also known as **licensing agreements**, they receive earnings called **royalties**. Royalties also come from franchise contracts. **Franchising** is a mode of business in which one party (the franchisor) allows another party (the franchisee) the use of a trademark that is an essential asset for the franchisee’s business. The franchisor also assists on a continuing basis in the operation of the business, such as by providing components, management services and technology.
INVESTMENTS

Foreign investment means ownership of foreign property in exchange for financial return, such as interest and dividends. Foreign investment takes two forms: direct and portfolio.

**Direct Investment:** A **direct investment** is one that gives the investor a controlling interest in a foreign company. Such a direct investment is also a **foreign direct investment (FDI)**, a term common to this text. If a company holds a minority stake and the remaining ownership is widely dispersed, no other owner may be able to counter the company effectively. When two or more companies share ownership of an FDI, the operation is a **joint venture**. When a government joins a company in an FDI, the operation is called a **mixed venture**, which is a type of joint venture.

**Portfolio Investment:** A portfolio investment is a non-controlling interest in a company or ownership of a loan to another party. Usually a portfolio investment takes one of two forms: stock in a company or loans to a company or country in the form of bonds, bills or notes that the investor purchases.

Foreign portfolio investments are important for most companies that have extensive international operations. Companies use them primarily for short-term financial gain, that is, as a means for a company to earn more money on its money with relative safety.

EVOLUTION OF STRATEGY IN THE INTERNATIONAL PROCESS

When we think of multinational enterprises, we often think of giant companies like IBM or Nestle, which have sales and production facilities in scores of countries. But companies do not start out as giants, and few think globally at their inception. As we discuss strategies, we shall note that companies are at different levels of internationalization and that their current status affects the strategic alternatives available to them.

Although there are variations in how international operations evolve, some overall patterns do emerge. Most of these patterns are a product of risk minimization behavior – most companies view foreign operations as being riskier than domestic ones because they must operate in unfamiliar environments. Thus, they initially undertake international activities reluctantly and follow practices to minimize their risks.

PATTERNS OF EXPANSION

In order to perform internationalization process the company has to follow several steps or axis. However, a company does not necessarily move at the same speed along each axis. A slow movement along one axis may free up resources that allow faster expansion along another. A company may lack initial capacity
to own facilities wholly in multiple foreign countries, so it may choose either to limit its foreign capital commitment by moving slowing from one axis to another axis. The various axis are defined below:

- Axis A – Impetus for International Business
- Axis B – Internal versus external handling for foreign operations
- Axis C – Mode of operations
- Axis D – Number of foreign countries in which a firm does business
- Axis E – Degree of similarity between foreign and domestic countries

**Passive to Active Expansion:** The impetus of strategic focus is defined in Axis A. Most new companies are established in response to domestic needs, and they frequently think only of domestic opportunities until a foreign opportunity presents itself to them. Often these companies have no idea of how their products became known abroad, but at this juncture, they must make a decision to export or not. Even large companies may move from passive to active expansion with aspects of their business.

**External to Internal Handling of Operations:** A company commonly uses intermediaries to handle foreign operations during early stages of international expansion because it minimizes risk. It commits fewer of its resources to international endeavors and relies on intermediaries that already know how to operate in the foreign market. But if the business grows successfully, the company will usually want to handle the operations with its own staff. This is because it has learned more about foreign operations, considers them less risky than at the onset, and realizes that the volume of business may justify the development of internal capabilities such as hiring trained personnel to maintain a department for foreign sales or purchases. This evolution is defined in Axis B.

**Deepening Mode of Commitment:** Axis C defined the importing and exporting is usually the first mode a company undertakes in becoming international. At an early stage of international involvement, importing and exporting require the least commitment and least risk to the company’s resources, such as capital, personnel, equipment and production facilities.

A company often moves into some type of foreign production after successfully building an export market. Initially this foreign production is apt to minimize the use of its resources by licensing to handle production abroad, sharing ownership in the foreign facility, or limiting the amount of manufacture, such as assembling output abroad.

A company typically does not abandon its early modes of operating abroad, such as importing and exporting, when it adopts other means of operating internationally. Rather, it usually either continues them by expanding its trade to new markets or complements them with new types of business activities.
**Geographic Diversification:** When companies first move internationally, they are most apt to do business in only one or very few foreign locations. Axis D shows that over time, the number of countries in which they operate increases. The initial narrow geographic expansion parallels the low early commitment of resources abroad. The choice of countries in this geographic expansion also tends to follow certain patterns as Axis E indicates. Initially, companies tend to go to those locations that are geographically close and similar.

The patterns most companies have followed in their international expansion are not necessarily optimal for their long-range performance. The initial movement into a nearby country, such as a U.S. company moving into Canada, may delay entry into faster growing markets. There is, however, evidence that many new companies are starting out with a global focus because of the international experience and education of their founders. Further, because of technological advancements, especially in communications and the World Wide Web, these start-up companies have a better idea of where their markets are globally and how they may gain resources from different countries.

**COUNTERVAILING FORCES**

In addition to the effect of external and competitive environmental factors, countervailing forces complicate decision making in international business. The strength of one force compared to that of another influences those choices available to companies that compete internationally. Some opposing choices that companies contend with are whether to institute global or national company practices, whether to focus on country or company competitiveness.

**GLOBALLY STANDARDIZED VERSUS NATIONALLY RESPONSIVE PRACTICES**

Any company operating internationally must decide between the advantages of globally standardized practices and those practices that respond to different national preferences. These advantages may vary by product, function, and country of operation.

The trends that have influenced the recent worldwide growth in international business –

- Rapid expansion of technology
- Liberalization of governmental trade policies
- Development of the institutions and services needed to support and facilitate international trade
- Increased global competition
- Reduce costs
However, when a company goes abroad, it faces conditions very different from those it encounters at home. The company may need to engage in national responsiveness, meaning it makes operating adjustments where it does business to reach a satisfactory level of performance. In such cases, a multi-domestic approach often works better than a global one because the company managers abroad are best able to assess and deal with the environments of the foreign countries in which the company operates.

**COUNTRY VERSUS COMPANY COMPETITIVENESS**

Companies at least those that are not government owned, may compete by seeking maximum production efficiency on a global scale. To accomplish this goal, the company’s production would use the best inputs for the price, even if the production location moved abroad. The company would then sell the output wherever it would fetch the best price. Such practices should lead to maximum performance for the company.

But countries also compete with each other. They do so in terms of fulfilling economic, political and social objectives. Countries are concerned not only with the absolute achievement of these objectives but also with how well they do compared to other countries. Keep in mind that competition among countries is the means to an end – the end being the well-being of a country’s citizens. However, there is no consensus on how to measure well-being and accepted indicators of current prosperity actually may foretell longer-term problems.

**SOVEREIGN VERSUS CROSS-NATIONAL RELATIONSHIPS**

Countries compete. They also cooperate. Countries sometimes cede sovereignty (freedom from external control) reluctantly because of coercion and international conflicts. However, they willingly cede sovereignty through treaties and agreements with other countries for the following reasons:

- To gain reciprocal advantages
- To attack problems that one country acting alone cannot solve
- To deal with areas of concern that lie outside the territory of all countries

Countries want to ensure that companies headquartered within their borders are not disadvantaged by foreign-country policies, so they enter into treaties and agreements with other countries on a variety of commercial activities, such as transportation and trade.

**INSTRUMENTS OF INTERNATIONAL TRADE CONTROL**

A country’s trade policy will have repercussions abroad, retaliation from foreign governments looms as a potential obstacle to achieving the desired objectives. The choice of instruments for achieving is therefore important, because each
may elicit different responses from domestic and foreign groups. One way to understand the types of instruments is to distinguish between those that affect the amount traded indirectly by directly influencing the prices of exports or imports and those that directly limit the amount that can be traded.

**TARIFFS**

Another common distinction is between tariff barriers and non-tariff barriers. Tariff barriers affect prices; non-tariff may affect either price or quantity directly. A **tariff**, or **duty**, which is the most common type of trade control, is a tax government’s levy on a good shipped internationally. If collected by the exported country, it is known as an **export tariff**; if collected by a country through which the goods have passed, it is a **transit tariff**; if collected by the importing country, it is an **import tariff**.

A government may assess a tariff on a per unit basis, in which case it is a **specific duty**. It may assess a tariff as a percentage of the value of the item, in which case it is an **ad valorem duty**. If it assesses both a specific duty and an ad valorem duty on the same product, the combination is a **compound duty**. A specific duty is easy for customs officials who collect duties to assess because they do not need to determine a good’s value on which to calculate a percentage tax.

**NONTARIFF BARRIERS: DIRECT PRICE INFLUENCES**

We have shown how tariff raise prices and limit trade. We will now explain other instruments governments use to limit trade by altering prices.

**Subsidies:** Countries sometimes make direct payments to domestic companies to compensate them for losses incurred from selling abroad, such as U.S. subsidies to cotton exporters. However, they most commonly provide other types of assistance to make it cheaper or more profitable for them to sell overseas. From an economic or market efficiency standpoint, service subsidies frequently are more justifiable than tariffs because they usually seek to overcome, rather than create, market imperfections, such as export and import promotion offices to help companies in emerging economies find foreign markets for the products.

**Aid and Loans:** Governments also give aid and loans to other countries. If the recipient is required to spend the funds in the donor country, which is known as tied aid or tied loans, some products can compete abroad that might otherwise be non-competitive. Most industrial countries also provide repayment insurance for their exporters, thus reducing the risk of non-payment for overseas sales.

**Customs Valuation:** Most countries have agreed on a procedure for assessing values when their customs agents levy tariffs. First, customs officials must use the invoice price. If there is none, of if its authenticity is doubtful, they must