CHAPTER 11

INTERNATIONAL BUSINESS - I

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- explain the meaning of international business;
- state as to why international business takes place and how does it differ from domestic business;
- describe the scope of international business and its benefits to the nation and business firms;
- identify and evaluate various modes of entry into international business; and
- analyse trends in India's involvement in international business.

Mr. Sudhir Manchanda is a small manufacturer of automobile components. His factory is located in Gurgaon and employs about 55 workers with an investment of Rs. 9.2 million in plant and machinery. Due to recession in the domestic market, he foresees prospects of his sales going up in the next few years in the domestic market. He is exploring the possibility of going international. Some of his competitors are already in export business. A casual talk with one of his close friends in the tyre business reveals that there is a substantial market for automobile components and accessories in South-East Asia and Middle East. But his friend also tells him, "Doing business internationally is not the same as carrying out business within the home country. International business is more complex as one has to operate under market conditions that are different from those that one faces in domestic business". Mr. Manchanda is, moreover, not sure as to how he should go about setting up international business. Should he himself identify and contact some overseas customers and start exporting directly to them or else route his products through export houses which specialise in exporting products made by others?

Mr. Manchanda's son who has just returned after an MBA in USA suggests that they should set up a fully owned factory in Bangkok for supplying to customers in South-East Asia and Middle East. Setting up a manufacturing plant there will help them save costs of transporting goods from India. This would also help them coming closer to the overseas customers. Mr. Manchanda is in a fix as to what to do. In the face of difficulties involved in overseas ventures as pointed out by his friend, he is wondering about the desirability of entering into global business. He is also not sure as to what the different ways of entering into international market are and which one will best suit his purpose.

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11.1 INTRODUCTION

Countries all over the world are undergoing a fundamental shift in the way they produce and market various products and services. The national economies which so far were pursuing the goal of self-reliance are now becoming increasingly dependent upon others for procuring as well as supplying various kinds of goods and services. Due to increased cross border trade and investments, countries are no more isolated.

The prime reason behind this radical change is the development of communication, technology, infrastructure etc. Emergence of newer modes of communication and development of faster and more efficient means of transportation have brought nations closer to one another. Countries that were cut-off from one another due to geographical distances and socio-economic differences have now started increasingly interacting with others. World Trade Organisation (WTO) and reforms carried out by the

governments of different countries have also been a major contributory factor to the increased interactions and business relations amongst the nations.

We are today living in a world where the obstacles to cross-border movement of goods and persons have substantially come down. The national economies are increasingly becoming borderless and getting integrated into the world economy. Little wonder that the world has today come to be known as a 'global village'. Business in the present day is no longer restricted to the boundaries of the domestic country. More and more firms are making forays into international business which presents them with numerous opportunities for growth and increased profits.

India has been trading with other countries for a long time. But it has of late considerably speeded up its process of integrating with the world economy and increasing its foreign trade and investments (see Box A: India Embarks on the Path to Globalisation).

11.1.1 Meaning of International Business

Business transaction taking place within the geographical boundaries of a nation is known as domestic or national business. It is also referred to as internal business or home trade. Manufacturing and trade beyond the boundaries of one's own country is known as international business. International or external business can, therefore, be defined as those business activities that take place across the

Box A
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 a severe debt trap and was facing crippling balance of payment crisis. In 1991, it approached the International Monetary Fund (IMF) for raising funds to tide over its balance of payment deficits. IMF agreed to lend money to India subject to the condition that India would undergo structural changes to be able to ensure repayment of borrowed funds.

India had no alternative but to agree to the proposal. It was the very conditions imposed by IMF which more or less forced India to liberalise its economic policies. Since then a fairly large amount of liberalisation at the economic front has taken place.

Though the process of reforms has somewhat slowed down, India is very much on the path to globalisation and integrating with the world economy. While, on the one hand, many multinational corporations (MNCs) have ventured into Indian market for selling their products and services; many Indian companies too have stepped out of the country to market their products and services to consumers in foreign countries.

national frontiers. 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.

It may be mentioned here that mostly people think of international business as international trade. But this is not true. No doubt international trade, comprising exports and imports of goods, has historically been an important component of international business. But of late, the scope of international business has substantially expanded. International trade in services such as international travel and tourism, transportation, communication, banking, warehousing, distribution and advertising has considerably grown. The other equally important developments are increased foreign investments and overseas production of goods and services. Companies have started increasingly making investments into foreign countries and undertaking production of goods and services in foreign countries to come closer to foreign customers and serve them more effectively at lower costs. All these activities form part of international business. To conclude, we can say that international business is a much broader term and is comprised of both the trade and production of goods and services across frontiers.

11.1.2 Reason for International Business

The fundamental reason behind international business is that the countries cannot produce equally well or cheaply all that they need. This is because of the unequal distribution of natural resources among them or differences in their productivity levels. Availability of various factors of production such as labour, capital and raw materials that are required for producing different goods and services differ among nations. Moreover, labour productivity and production costs differ among nations due to various socio-economic, geographical and political reasons.

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International business involves commercial activities that cross national frontiers.

Roger Bennett

International business consists of transactions that are devised and carried out across national borders to satisfy the objectives of the individuals, companies and organisations. These transactions take on various forms which are often interrelated.

Michael R. Czinkota

International business 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.

John D. Daniels and Lee H. Radebaugh

Due to these differences, it is not uncommon to find one particular country being in a better position to produce better quality products and/ or at lower costs than what other nations can do. In other words, we can say that some countries are in an advantageous position in producing select goods and services which other countries cannot produce that effectively and efficiently, and vice-versa. As a result, each country finds it advantageous to produce those select goods and services that it can produce more effectively and efficiently at home, and procuring the rest through trade with other countries which the other countries can produce at lower costs. This is precisely the reason as to why countries trade with others and engage in what is known as international business.

The international business as it exists today is to a great extent the result of geographical specialisation as pointed out above. Fundamentally, it is for the same reason that domestic trade between two states or regions within a country takes place. Most states or regions within a country tend to specialise in the production of goods and services for which they are best suited. In India, for example, while West Bengal specialises in jute products; Mumbai and neighbouring areas in Maharashtra are more involved with the production of cotton textiles. The same principle of territorial division of labour is applicable at the international level too. Most developing countries which are labour abundant, for instance, specialise in producing and exporting garments. Since they lack capital and technology, they import textile machinery from the developed nations which the latter are in a position to produce more efficiently.

What is true for the nation is more or less true for firms. Firms too engage in international business to import what is available at lower prices in other countries, and export goods to other countries where they can fetch better prices for their products. Besides price considerations, there are several other benefits which nations and firms derive from international business. In a way, these other benefits too provide an impetus to nations and firms to engage in international business. We shall turn our attention to some of these benefits accruing to nations and firms from engaging in international business in a later section.

11.1.3 International Business vs. Domestic Business

Conducting and managing international business operations is more complex than undertaking domestic business. Because of variations in political, social, cultural and economic environments across countries, business firms find it difficult to extend their domestic business strategy to foreign markets. To be successful in the overseas markets, they need to adapt their product, pricing, promotion and distribution strategies and overall business plans to suit the specific requirements of the target foreign markets (see Box B on Firms need to be Cognisant of

Environmental Differences). Key aspects in respect of which domestic and international businesses differ from each other are discussed below.

(i) Nationality of buyers and sellers: Nationality of the key participants (i.e., buyers and sellers) to the business deals differs between domestic and international businesses. In the case of domestic business, both the buyers and sellers are from the same country. This makes it easier for both the parties to understand each other and enter into business deals. But this is not the case with international business where buyers and sellers come from different countries. Because of differences in their languages, attitudes, social customs and business goals and practices, it becomes relatively more difficult for them to interact with one another and finalise business transactions.

(ii) Nationality of other stakeholders: Domestic and international businesses also differ in respect of the nationalities of the other stakeholders such as employees, suppliers, shareholders/ partners and general public who interact with business firms. While in the case of domestic business all such factors belong to one country, and therefore relatively speaking depict more consistency in their value systems and behaviours; decision making in international business becomes much more complex as the concerned business firms have to take into account a wider set of values and aspirations of the stakeholders belonging to different nations.

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Box B
Firms need to be Cognisant of Environmental Differences

It is to be kept in mind that conducting and managing international business is not an easy venture. It is more difficult to manage international business operations due to variations in the political, social, cultural and economic environments that differ from country to country.

Simply being aware of these differences is not sufficient. One also needs to be sensitive and responsive to these changes by way of introducing adaptations in their marketing programmes and business strategies. It is, for instance, a well known fact that because of poor lower per capita income, consumers in most of the developing African and Asian countries are price sensitive and prefer to buy less expensive products. But consumers in the developed countries like Japan, United States, Canada, France, Germany and Switzerland have a marked preference for high quality and high priced products due to their better ability to pay. Business prudence, therefore, demands that the firms interested in marketing to these countries are aware of such differences among the countries, and design their strategies accordingly. It will be in the fitness of things if the firms interested in exporting to these countries produce less expensive products for the consumers in the African and Asian regions, and design and develop high quality products for consumers in Japan and most of the European and North American countries.

(iii) Mobility of factors of production: The degree of mobility of factors like labour and capital is generally less between countries than within a country. While these factors of movement can move freely within the country, there exist various restrictions to their movement across nations. Apart from legal restrictions, even the variations in socio-cultural environments, geographic influences and economic conditions come in a big way in their movement across countries. This is especially true of the labour which finds it difficult to adjust to the climatic, economic and socio-cultural conditions that differ from country to country.

(iv) Customer heterogeneity across markets: Since buyers in international markets hail from different countries, they differ in their socio-cultural background. Differences in their tastes, fashions, languages, beliefs and customs, attitudes and product preferences cause variations in not only their demand for different products and services, but also in variations in their communication patterns and purchase behaviours. It is precisely because of the socio-cultural differences that while people in China prefer bicycles, the Japanese in contrast like to ride bikes. Similarly, while people in India use right-hand driven cars, Americans drive cars fitted with steering, brakes, etc., on the left side. Moreover, while people in the United States change their TV, bike and other consumer durables very frequently — within two to three years of their purchase, Indians mostly do not go in for such replacements until the products currently with them have totally worn out.

Such variations greatly complicate the task of designing products and evolving strategies appropriate for customers in different countries. Though to some extent customers within a country too differ in their tastes and preferences. These differences become more striking when we compare customers across nations.

(v) Differences in business systems and practices: The differences in business systems and practices are considerably much more among countries than within a country. Countries differ from one another in terms of their socio-economic development, availability, cost and efficiency of economic infrastructure and market support services, and business customs and practices due to their socio-economic milieu and historical coincidences. All such differences make it necessary for firms interested in entering into international markets to adapt their production, finance, human resource and marketing plans as per the conditions prevailing in the international markets.

(vi) Political system and risks: Political factors such as the type of government, political party system, political ideology, political risks, etc., have a profound impact on business operations. Since a business person is familiar with the political environment of his/her country, he/she can well understand it and predict its impact on business operations. But this is not the

case with international business. Political environment differs from one country to another. One needs to make special efforts to understand the differing political environments and their business implications. Since political environment keeps on changing, one needs to monitor political changes on an ongoing basis in the concerned countries and devise strategies to deal with diverse political risks.

A major problem with a foreign country's political environment is a tendency among nations to favour products and services originating in their own countries to those coming from other countries. While this is not a problem for business firms operating domestically, it quite often becomes a severe problem for the firms interested in exporting their goods and services to other nations or setting up their plants in the overseas markets.

(vii) Business regulations and policies: Coupled with its socio-economic environment and political philosophy, each country evolves its own set of business laws and regulations. Though these laws, regulations and economic policies are more or less uniformly applicable within a country, they differ widely among nations. Tariff and taxation policies, import quota system, subsidies and other controls adopted by a nation are not the same as in other countries and often discriminate against foreign products, services and capital.

(viii) Currency used in business transactions: Another important difference between domestic and international business is that the latter involves the use of different currencies. Since the exchange rate, i.e., the price of one currency expressed in relation to that of another country's currency, keeps on fluctuating, it adds to the problems of international business firms in fixing prices of their products and hedging against foreign exchange risks.

11.1.4 Scope of International Business

As pointed out earlier, international business is much broader than international trade. It includes not only international trade (i.e., export and import of goods and services), but also a wide variety of other ways in which the firms operate internationally. Major forms of business operations that constitute international business are as follows.

(i) Merchandise exports and imports: Merchandise means goods that are tangible, i.e., those that can be seen and touched. When viewed from this perceptive, it is clear that while merchandise exports means sending tangible goods abroad, merchandise imports means bringing tangible goods from a foreign country to one's own country. Merchandise exports and imports, also known as trade in goods, include only tangible goods and exclude trade in services.

(ii) Service exports and imports: Service exports and imports involve trade in intangibles. It is because of the intangible aspect of services that trade in services is also known as *invisible trade*. A wide variety of services are

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Table 11.1 Major Difference between Domestic and International Business

	Basis	Domestic business	International business
1.	Nationality of buyers and sellers	People or organisations from one nation participate in domestic business transactions.	People or organisations of different countries participate in international business transactions.
2.	Nationality of other stakeholders	Various other stakeholders such as suppliers, employees, middlemen, shareholders and partners are usually citizens of the same country.	Various other stakeholders such as suppliers, employees, middlemen, shareholders and partners are from different nations.
3.	Mobility of factors of production	The degree of mobility of factors of production like labour and capital is relatively more within a country.	The degree of mobility of factors of production like labour and capital across nations is relatively less.
4.	Customer heterogeneity across markets	Domestic markets are relatively more homogeneous in nature.	International markets lack homogeneity due to differences in language, preferences, customs, etc., across markets.
5.	Differences in business systems and practices	Business systems and practices are relatively more homogeneous within a country.	Business systems and practices vary considerably across countries.
6.	Political system and risks	Domestic business is subject to political system and risks of one single country.	Different countries have different forms of political systems and different degrees of risks which often become a barrier to international business.
7.	Business regulations and policies	Domestic business is subject to rules, laws and policies, taxation system, etc., of a single country.	International business transactions are subject to rules, laws and policies, tariffs and quotas, etc. of multiple countries.
8.	Currency used in business transactions	Currency of domestic country is used.	International business transactions involve use of currencies of more than one country.

traded internationally and these include: tourism and travel, boarding and lodging (hotel and restaurants), entertainment and recreation, transportation, professional services (such as training, recruitment, consultancy and research), communication (postal, telephone, fax, courier and other audio-visual services), construction and engineering, marketing (e.g., wholesaling, retailing, advertising, marketing research and warehousing), educational and financial services (such as banking and insurance). Of these, tourism, transportation and business services are major constituents of world trade in services (see Box C).

(iii) Licensing and franchising: Permitting another party in a foreign country to produce and sell goods under your trademarks, patents or copy rights in lieu of some fee is another way of entering into international business. It is under the licensing system that Pepsi and Coca Cola are produced and sold all over the world by local bottlers in foreign countries. Franchising is similar to licensing, but it is a term used in connection with the provision of services. McDonalds, for instance, operates fast food restaurants the world over through its franchising system.

(iv) Foreign investments: Foreign investment is another important form of international business. Foreign investment involves investments of funds abroad in exchange for financial return. Foreign investment can be of two types: direct and portfolio investments.

Direct investment takes place when a company directly invests in properties

Box C
Tourism, Transportation and Business Services dominate International Trade in Services

Tourism and transportation have emerged as major components of international trade in services. Most of the airlines, shipping companies, travel agencies and hotels get their major share of revenues from their overseas customers and operations abroad. Several countries have come to heavily depend on services as an important source of foreign exchange earnings and employment. India, for example, earns a sizeable amount of foreign exchange from exports of services related to travel and tourism.

Business services: When one country provides services to other country and in the process earns foreign exchange, this is also treated as a form of international business activity. Fee received for services like banking, insurance, rentals, engineering and management services form part of country's foreign exchange earnings. Undertaking of construction projects in foreign countries is also an example of export of business services. The other examples of such services include overseas management contracts where arrangements are made by one company of a country which provides personnel to perform general or specialised management functions for another company in a foreign country in lieu of the other country.

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such as plant and machinery in foreign countries with a view to undertaking production and marketing of goods and services in those countries. Direct investment provides the investor a controlling interest in a foreign company. This is otherwise known as Foreign Direct Investment, i.e., FDI. When investments in production and marketing facilities are made jointly with one or more foreign parties, such an operation is known as a *joint venture*. A company, if it so desires, can also set up a *wholly owned subsidiary* abroad by making 100 per cent investment in foreign ventures, and thus acquiring full control over subsidiary's operations in the foreign market.

A portfolio investment, on the other hand, is an investment that a company makes into another company by the way of acquiring shares or providing loans to the latter, and earns income by way of dividends or interest on loans. Unlike foreign direct investments, the investor under portfolio investment does not get directly involved into production and marketing operations. It simply earns an income by investing in shares, bonds, bills, or notes in a foreign country or providing loans to foreign business firms.

11.1.5 Benefits of International Business

Notwithstanding greater complexities and risks, international business is important to both nations and business firms. It offers them several benefits. Growing realisation of these benefits over time has in fact been a contributory factor to the expansion of trade and investment amongst nations, resulting in the phenomenon of globalisation. Some of the benefits of international business to the nations and business firms are discussed below.

Benefits to Nations

(i) Earning of foreign exchange: International business helps a country to earn foreign exchange which it can later use for meeting its imports of capital goods, technology, petroleum products and fertilisers, pharmaceutical products and a host of other consumer products which otherwise might not be available domestically.

(ii) More efficient use of resources: As stated earlier, international business operates on a simple principle — produce what your country can produce more efficiently, and trade the surplus production so generated with other countries to procure what they can produce more efficiently. When countries trade on this principle, they end up producing much more than what they can when each of them attempts to produce all the goods and services on its own. If such an enhanced pool of goods and services is distributed equitably amongst nations, it benefits all the trading nations.

(iii) Improving growth prospects and employment potentials: Producing solely for the purposes of domestic consumption severely restricts a country's prospects for growth and

employment. Many countries, especially the developing ones, could not execute their plans to produce on a larger scale, and thus create employment for people because their domestic market was not large enough to absorb all that extra production. Later on a few countries such as Singapore, South Korea and China which saw markets for their products in the foreign countries embarked upon the strategy 'export and flourish', and soon became the star performers on the world map. This helped them not only in improving their growth prospects, but also created opportunities for employment of people living in these countries.

(iv) Increased standard of living: In the absence of international trade of goods and services, it would not have been possible for the world community to consume goods and services produced in other countries that the people in these countries are able to consume and enjoy a higher standard of living.

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Benefits to Firms

(i) Prospects for higher profits: International business can be more profitable than the domestic business. When the domestic prices are lower, business firms can earn more profits by selling their products in countries where prices are high.

(ii) Increased capacity utilisation: Many firms setup production capacities for their products which are in excess of demand in the domestic market. By planning overseas expansion and procuring orders from foreign customers, they can think of making use of their surplus production capacities and also improving the profitability of their operations. Production on a larger scale often leads to economies of scale, which in turn lowers production cost and improves per unit profit margin.

(iii) Prospects for growth: Business firms find it quite frustrating when demand for their products starts getting saturated in the domestic market. Such firms can considerably improve prospects of their growth by plunging into overseas markets. This is precisely what has prompted many of the multinationals from the developed countries to enter into markets of developing countries. While demand in their home countries has got almost saturated, they realised their products were in demand in the developing countries and demand was picking up quite fast.

(iv) Way out to intense competition in domestic market: When competition in the domestic market is very intense, internationalisation seems to be the only way to achieve significant growth. Highly competitive domestic market drives many companies to go international in search of markets for their products. International business thus acts as a catalyst of growth for firms facing tough market conditions on the domestic turf.

(v) Improved business vision: The growth of international business of many companies is essentially a part of their business policies or strategic

management. The vision to become international comes from the urge to grow, the need to become more competitive, the need to diversify and to gain strategic advantages of internationalisation.

11.2 Modes of Entry into International Business

Simply speaking, the term mode means the manner or way. The phrase 'modes of entry into international business', therefore, means various ways in which a company can enter into international business. While discussing the meaning and scope of international business, we have already familiarised you with some of the modes of entry into international business. In the following sections, we shall discuss in detail important ways of entering into international business along with their advantages and limitations. Such a discussion will enable you to know as to which mode is more suitable under what conditions.

11.2.1 Exporting and Importing

Exporting refers to sending of goods and services from the home country to a foreign country. In a similar vein, importing is purchase of foreign products and bringing them into one's home country. There are two important ways in which a firm can export or import products: direct and indirect exporting/importing. In the case of direct exporting/importing, a firm itself approaches the overseas buyers/suppliers and looks after all the formalities related to exporting/importing activities including those related to shipment and financing of goods and services. Indirect exporting/importing, on the other hand, is one where the firm's participation in the export/import operations is minimum, and most of the tasks relating to export/import of the goods are carried out by some middle men such as export houses or buying offices of overseas customers located in the home country or wholesale importers in the case of import operations. Such firms do not directly deal with overseas customers in the case of exports and suppliers in the case of imports.

Advantages

Major advantages of exporting include:

- As compared to other modes of entry, exporting/importing is the easiest way of gaining entry into international markets. It is less complex an activity than setting up and managing joint-ventures or wholly owned subsidiaries abroad.
- Exporting/importing is less involving in the sense that business firms are not required to invest that much time and money as is needed when they desire to enter into joint ventures or set up manufacturing plants and facilities in host countries.
- Since exporting/importing does not require much of investment in foreign countries, exposure to

foreign investment risks is nil or much lower than that is present when firms opt for other modes of entry into international business.

Limitations

Major limitations of exporting/ importing as an entry mode of international business are as follows:

- Since the goods physically move from one country to another, exporting/importing involves additional packaging, transportation and insurance costs. Especially in the case of heavy items, transportation costs alone become an inhibiting factor to their exports and imports. On reaching the shores of foreign countries, such products are subject to custom duty and a variety of other levies and charges. Taken together, all these expenses and payments substantially increase product costs and make them less competitive.
- Exporting is not a feasible option when import restrictions exist in a foreign country. In such a situation, firms have no alternative but to opt for other entry modes such as licensing/franchising or joint venture which makes it feasible to make the product available by way of producing and marketing it locally in foreign countries.
- Export firms basically operate from their home country. They produce in the home country and then ship the goods to foreign countries. Except a few visits made by the executives of export firms to foreign countries to promote their products, the export firms in general do not have much contact with the foreign markets. This puts the export firms in a disadvantageous position vis-à-vis the local firms which are very near the customers and are able to better understand and serve them.

Despite the above mentioned limitations, exporting/importing is the most preferred way for business firms when they are getting initially involved with international business. As usually is the case, firms start their overseas operations with exports and imports, and later having gained familiarity with the foreign market operations switch over to other forms of international business operations.

11.2.2 Contract Manufacturing

Contract manufacturing refers to a type of international business where a firm enters into a contract with one or a few local manufacturers in foreign countries to get certain components or goods produced as per its specifications. Contract manufacturing, also known as *outsourcing*, can take three major forms:

- Production of certain components such as automobile components or shoe uppers to be used later for producing final products such as cars and shoes;
- Assembly of components into final products such as assembly of hard disk, mother board, floppy disk drive and modem chip into computers; and

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- Complete manufacture of the products such as garments.

The goods are produced or assembled by the local manufacturers as per the technology and management guidance provided to them by the foreign company. The goods so manufactured or assembled by the local producers are delivered to the international firm for use in its final products or out rightly sold as finished products by the international firm under its brand names in various countries including the home, host and other countries. All the major international companies such as Nike, Reebok, Levis and Wrangler today get their products or components produced in the developing countries under contract manufacturing.

Advantages

Contract manufacturing offers several advantages to both the international company and local producers in the foreign countries.

- Contract manufacturing permits the international firms to get the goods produced on a large scale without requiring investment in setting up production facilities. These firms make use of the production facilities already existing in the foreign countries.
- Since there is no or little investment in the foreign countries, there is hardly any investment risk involved in the foreign countries.
- Contract manufacturing also gives an advantage to the international company of getting products manufactured or assembled at lower costs especially if the local producers happen to be situated in countries which have lower material and labour costs.
- Local producers in foreign countries also gain from contract manufacturing. If they have any idle production capacities, manufacturing jobs obtained on contract basis in a way provide a ready market for their products and ensure greater utilisation of their production capacities. This is how the Godrej group is benefitting from contract manufacturing in India. It is manufacturing soaps under contract for many multinationals including Dettol soap for Reckitt and Colman. This has considerably helped it in making use of its excess soap manufacturing capacity.
- The local manufacturer also gets the opportunity to get involved with international business and avail incentives, if any, available to the export firms in case the international firm desires goods so produced be delivered to its home country or to some other foreign countries.

Limitations

The major disadvantages of contract manufacturing to international firm and local producer in foreign countries are as follows:

- Local firms might not adhere to production design and quality standards, thus causing serious product quality problems to the international firm.

- 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.
- The local firm producing under contract manufacturing is not free to sell the contracted output as per its will. It has to sell the goods to the international company at predetermined prices. This results in lower profits for the local firm if the open market prices for such goods happen to be higher than the prices agreed upon under the contract.

11.2.3 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 such permission to the other firm is known as *licensor* and the other firm in the foreign country that acquires such rights to use technology or patents is called the *licensee*. It may be mentioned here that it is not only technology that is licensed. In the fashion industry, a number of designers license the use of their names. In some cases, there is exchange of technology between the two firms. Sometimes there is mutual exchange of knowledge, technology and/or patents between the firms which is known as *cross-licensing*.

Franchising is a term very similar to licensing. One major distinction between the two is that while the former is used in connection with production and marketing of goods, the term franchising applies to service business. The other point of difference between the two is that franchising is relatively more stringent than licensing. Franchisers usually set strict rules and regulations as to how the franchisees should operate while running their business. Barring these two differences, franchising is pretty much the same as licensing. Like in the case of licensing, a franchising agreement too involves grant of rights by one party to another for use of technology, trademark and patents in return of the agreed payment for a certain period of time. The parent company is called the franchiser and the other party to the

"Franchising is basically a specialised form of licensing in which the franchisor not only sells intangible property (normally a trademark) to the franchisee, but also insists that the franchisee agrees to abide by strict rules as to how it does business."

Charles W.L. Hill

Franchising is a "form of licensing in which a parent company (the franchisor) grants another independent entity (the franchisee) the right to do business in a prescribed manner. This right can take the form of selling the franchisers products, 'using its name, production and marketing technique, or general business approach."

Donald W. Hackett

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agreement is called franchisee. The franchiser can be any service provider be it a restaurant, hotel, travel agency, bank wholesaler or even a retailer - who has developed a unique technique for creating and marketing of services under its own name and trade mark. It is the uniqueness of the technique that gives the franchiser an edge over its competitors in the field, and makes the would-be-service providers interested in joining the franchising system. McDonald, Pizza Hut and Wal-Mart are examples of some of the leading franchisers operating worldwide.

Advantages

As compared to joint ventures and wholly owned subsidiaries, licensing/ franchising is relatively a much easier mode of entering into foreign markets with proven product/technology without much business risks and investments. Some of the specific advantages of licensing are as follows:

- Under the licensing/franchising system, it is the licensor/ franchiser who sets up the business unit and invests his/her own money in the business. As such, the licensor/franchiser has to virtually make no investments abroad. Licensing/franchising is, therefore, considered a less expensive mode of entering into international business.
- Since no or very little foreign investment is involved, licensor/ franchiser is not a party to the losses, if any, that occur to foreign business. Licensor/franchiser is paid by the licensee/franchisee by way of fees fixed in advance as a percentage of production or sales turnover. This royalty or fee keeps accruing to the licensor/franchiser so long as the production and sales keep on taking place in the licensee's/franchisee's business unit.
- Since the business in the foreign country is managed by the licensee/franchisee who is a local person, there are lower risks of business takeovers or government interventions.
- Licensee/franchisee being a local person has greater market knowledge and contacts which can prove quite helpful to the licensor/franchiser in successfully conducting its marketing operations.
- As per the terms of the licensing/ franchising agreement, only the parties to the licensing/franchising agreement are legally entitled to make use of the licensor's/ franchiser's copyrights, patents and brand names in foreign countries. As a result, other firms in the foreign market cannot make use of such trademarks and patents.

Limitations

Licensing/franchising as a mode of international business suffers from the following weaknesses.

- When a licensee/franchisee becomes skilled in the manufacture and marketing of the licensed/franchised products,

there is a danger that the licensee can start marketing an identical product under a slightly different brand name. This can cause severe competition to the licenser/ franchiser.

- If not maintained properly, trade secrets can get divulged to others in the foreign markets. Such lapses on the part of the licensee/ franchisee can cause severe losses to the licensor/franchiser.
- Over time, conflicts often develop between the licensor/franchiser and licensee/franchisee over issues such as maintenance of accounts, payment of royalty and non-adherence to norms relating to production of quality products. These differences often result in costly litigations, causing harm to both the parties.

11.2.4 Joint Ventures

Joint venture is a very common strategy for entering into foreign markets. A joint venture means establishing a firm that is jointly owned by two or more otherwise independent firms. In the widest sense of the term, it can also be described as any form of association which implies collaboration for more than a transitory period. A joint ownership venture may be brought about in three major ways:

(i) Foreign investor buying an interest in a local company

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

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

Advantages

Major advantages of joint venture include:

- Since the local partner also contributes to the equity capital of such a venture, the international firm finds it financially less burdensome to expand globally.
- Joint ventures make it possible to execute large projects requiring huge capital outlays and manpower.
- The foreign business firm benefits from a local partner's knowledge of the host countries regarding the competitive conditions, culture, language, political systems and business systems.
- In many cases entering into a foreign market is very costly and risky. This can be avoided by sharing costs and/or risks with a local partner under joint venture agreements.

Limitations

Major limitations of a joint venture are discussed below:

- Foreign firms entering into joint ventures share the technology and trade secrets with local firms in foreign countries, thus always running the risks of such a

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technology and secrets being disclosed to others.
- The dual ownership arrangement may lead to conflicts, resulting in battle for control between the investing firms.

11.2.5 Wholly Owned Subsidiaries

This entry mode of international business is preferred by companies which want to exercise full control over their overseas operations. The parent company acquires full control over the foreign company by making 100 per cent investment in its equity capital. A wholly owned subsidiary in a foreign market can be established in either of the two ways:

(i) Setting up a new firm altogether to start operations in a foreign country — also referred to as a green field venture, or

(ii) Acquiring an established firm in the foreign country and using that firm to manufacture and/or promote its products in the host nation.

Advantages

Major advantages of a wholly owned subsidiary in a foreign country are as follows:

- The parent firm is able to exercise full control over its operations in foreign countries.
- Since the parent company on its own looks after the entire operations of foreign subsidiary, it is not required to disclose its technology or trade secrets to others.

Limitations

The limitations of setting up a wholly owned subsidiary abroad include:

- The parent company has to make 100 per cent equity investments in the foreign subsidiaries. This form of international business is, therefore, not suitable for small and medium size firms which do not have enough funds with them to invest abroad.
- Since the parent company owns 100 per cent equity in the foreign company, it alone has to bear the entire losses resulting from failure of its foreign operations.
- Some countries are averse to setting up of 100 per cent wholly owned subsidiaries by foreigners in their countries. This form of international business operations, therefore, becomes subject to higher political risks.

11.3 India's Involvement in World Business

India is now the 10th largest economy in the world and the fastest growing economy, next only to China. As per the Goldman Sach Report 2004, India is poised to be the second largest economy by 2050. Despite these features, India's involvement with international business is not very impressive. India's share in world trade in 2003 was abysmally low i.e., just 0.8 per cent as compared to those of other developing countries such as China (5.9 per cent), Hong Kong (3.0 per cent), South Korea (2.6 per cent), Malaysia

(1.3 per cent), Singapore (1.9 per cent), and Thailand (1.1 per cent). Even in respect of foreign investments, India has been considerably lagging behind other countries. The following sections provide an overview of the major trends and developments in India's foreign trade and investments.

11.3.1 India's Foreign Trade in Goods

India accounts for a small share in world trade, its exports and imports during the same period have increased more than 3 times, from Rs 5,01,065 in 2004-05 to 16,51,240 to 2011-12. However, the trade balance had decreased to Rs 5,18,202 in 2009-10.

Compostion wise, textiles and garments, gems and jewellery, engineering products and chemicals and related products and agricultural and allied products are major items of India's exports. In many individual product items such as tea, pearls, precious and

Table 11.2 India's Exports and Imports: 2004-05 to 2011-12

Year	Exports	Imports	Trade Balance
2004-05	375340	501065	–125725
2005-06	456418	660409	–203991
2006-07	571779	840506	–268727
2007-08	655864	1012312	–356448
2008-09	840755	1374436	–533681
2009-10	845534	1363736	–518202
2010-11	1142649	1683467	–540818
2011-12(P)	1024707	1651240	–626533

Source: *DGCIS, Calcutta, as Reported in Government of India, Economic Survey: 2011-12, New Delhi*

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constitute major economic activities for the country. Due to faster growth achieved at the external front, share of foreign trade in the country's Gross Domestic Product (GDP) has considerably increased from 14.6 per cent in 1990-91 to 24.1 per cent in 2003-04.

In absolute terms, both the exports and imports have witnessed phenomenal growth over the years. From 2004-05 to 2011-12 there has been an increase in exports from Rs 3,75,340 to Rs 10,24,707 which is almost 3 times in 7 years. Imports semi-precious stones, medicinal and pharmaceutical products, rice, spices, iron ore and concentrates, leather and leather manufactures, textile yarns fabrics, garments and tobacco, its share is much higher. India even holds the distinct position of being the largest exporter in the world in select commodities such as basmati rice, tea, and ayurvedic products. In 2009-10 and 2010-11, India's exports of agricultural and allied products, ores and minerals, engineering goods, chemicals, leather and manufactures have declined considerably. Only

Table 11.3 Commodity Composition of India's Exports

Product	Percentage Share	
	2009-10	2010-11
Agriculture and Allied	10.0	9.9
Ores and Minerals	4.9	4.0
Manufactured Goods	67.4	68.0
Textiles	8.1	6.7
Gems and Jewellery	16.3	14.7
Engineering Goods	10.9	12.1
Chemicals and Related Products	6.3	5.5
Leathers and Manufactures	1.2	0.9
Petroleum, Crude and Related Products	16.2	16.8
Others	1.5	1.2
Total Exports	**100.0**	**100.0**

Source: *DGCIS, Calcutta, as Reported in Government of India, Economic Survey: 2011-12. New Delhi*

petroleum products have increased (See Table 11.3).

So far as imports are concerned, products likes crude oil and petroleum products, capital goods (i.e., machinery), electronic goods, pearl, precious and semi-precious stones, gold, silver and chemicals constitute major items of India's imports. From Table 11.4 it can be seen that in 2009-10 and 2010-11 imports of all items are generally on the increase. Only import of edible oils, chemicals and electronic goods as a share in that total imports has declined slightly.

India's eleven major trading partners include USA, UK, Belgium, Germany, Japan, Switzerland, Hong Kong, UAE, China, Singapore and

Table 11.4 Commodity Composition of India's Imports

Product	Percentage Share	
	2009-10	2010-11
Petroleum, Oil and Lubricants (POL)	30.1	28.6
Pearl, Precious and Semi-precious Stones	5.6	9.4
Capital Goods	15.0	13.1
Electronic Goods	7.3	7.2
Gold and Silver	10.3	11.5
Chemicals	5.2	5.2
Edible Oils	1.9	1.8
Coal	3.1	2.7
Iron and Steel	2.9	2.8
Professional Instruments	1.3	1.1
Total Imports	**100.0**	**100.0**

Source: *DGCIS, Calcutta, as Reported in Government of India, Economic Survey: 2011-12, New Delhi*

Malaysia. While USA has been India's leading trade partner with a share of 11.6 per cent in India's total trade (including both exports and imports), shares of other ten countries have been in the range of 2.1 per cent to 4.4 per cent in 2003-04. In 2008-09, 2009-10 and 2010-11, India's major trading partners have changed, UAE and China on top of the list, USA has come down to number 3 and UK to number 15 if compared to 2003-04 data (see Table 11.5).

11.3.2 India's Trade in Services

India's trade in services have also grown manifold over the years. Table 11.6 contains data on exports

Table 11.5 India's Major Trading Partners

Country	Percentage Share in India's Total Trade (Exports Imports)		
	2008-09	2009-10	2010-11
UAE	9.76	9.29	10.81
China	8.59	9.09	10.16
USA	8.18	7.83	7.35
Saudi Arabia	5.09	4.49	4.13
Switzerland	2.54	3.26	4.10
Hong Kong	2.71	2.70	3.18
Germany	3.80	3.37	3.00
Singapore	3.26	3.01	2.81
Indonesia	1.91	2.52	2.60
Belgium	2.09	2.09	2.40
Korea	2.62	2.57	2.35
Japan	2.24	2.22	2.23
Iran	3.04	2.87	2.20
Nigeria	2.12	1.86	2.10
UK	2.58	2.29	2.02
Total of top 15 countries	60.54	59.45	61.45
Others	49.46	50.55	48.55
Total Trade	**100.00**	**100.00**	**100.00**

Source: *DGCIS, Calcutta, as Reported in Government of India, Economic Survey: 2011-12, New Delhi*

Table 11.6 India's Trade in Services

	1960-61	1970-71	1980-81	1990-91	2000-01	2002-03	2004-05
Exports							
Foreign Travel	15	36	964	2613	16064	15991	18873
Transportation	45	109	361	1765	9364	12261	14958
Insurance	8	12	51	199	1234	1783	1927
Imports							
Foreign Travel	12	18	90	703	12741	16155	16111
Transportation	25	78	355	1961	16172	15826	10703
Insurance	6	12	34	159	1004	1687	1672

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Table 11.7 Percentage Shares of Major Services to Total Services Exports

Year	Travel	Transportation	Software	Miscellaneous
1995-96	36.9	27.4	10.2	22.9
2000-01	21.5	12.6	39.0	21.3
2001-02	18.3	12.6	44.1	20.3
2002-03	16.0	12.2	46.2	22.4
2003-04	16.5	13.1	48.9	18.7
2010-11	11.5	10.7	41.7	34.2

Compiled from Data as Reported in Government of India, Economic Survey, 2011-12, New Delhi

and imports of India's three services which have been historically important to India. It is obvious from the table that both the exports and imports of services relating to foreign travel, transportation and insurance have increased spectacularly during the last four decades.

What is more remarkable is the change in the composition of services exports. Software and other miscellaneous services (including professional technical and business services) have emerged as the main categories of India's exports of services. While the relative share of travel and transportation has declined from 64.3 per cent in 1995-96 to 29.6 per cent in 2003-2004, the share of software exports has gone up from 10.2 per cent to around 49 per cent in the corresponding period (See Table 11.7). It is seen that in 2010-11, the percentage share of travel, transportation and software services to total services has gone down in comparison to the trend in earlier years.

11.3.3 India's Foreign Investments

Data relating to India's foreign investments — both inward and outward — are provided in Table 11.8. It can be seen that there has been a phenomenal increase in foreign investments flow into and from India. While the inward foreign investments have grown more than 750 times from just Rs 201 crores in 1990-91 to Rs 1,51,406 crores in 2003-04, India's investments abroad have increased much more exponentially — around 4,927 times — from Rs 19 crores in 1990-91 to Rs 8,3,616 crores in 2003-04.

Table 11.8 Foreign Investment Flows into and out of India

Value: Rs in Crores

	1990-91	2000-01	2001-02	2002-03	2003-04
Inflows	201	80824	73907	67756	151406
Outflows	19	54080	41987	47658	83616
Net	182	26744	31920	22098	67592

Key Terms

International business
International trade
Merchandise trade
Invisible trade
Foreign investment
FDI
Portfolio investment
Exporting
Importing
Contract-manufacturing
Licensing
Franchising
Outsourcing
Joint ventures
Wholly owned subsidiaries

SUMMARY

International Business: International business refers to business activities that take place across national frontiers. Though many people use the terms international business and international trade synonymously, the former is a much broader term. International business involves not only trade in goods and services, but also other operations such as production and marketing of goods and services in foreign countries.

Reasons: The primary reason for international business is that nations cannot efficiently produce all that they require. Due to differences in resource endowments and labour productivity, countries find it much more advantageous to produce goods and services in which they have cost advantage and trade the surplus in such goods and services with other nations in exchange of goods and services which others can produce more efficiently.

International vs Domestic business: Conducting and managing international business operations is more complex than undertaking domestic business. Differences in the nationality of parties involved, relatively less mobility of factors of production, customer heterogeneity across markets, variations in business practises and political systems, varied business regulations and policies, use of different currencies are the key aspects that differentiate international businesses from domestic business. These, moreover, are the factors that make international business much more complex and a difficult activity.

Scope: Scope of international business is quite wide. It includes not only merchandise exports, but also trade in services, licensing and franchising as well as foreign investments.

Benefits: International business benefits both the nations and firms. Nations gain by way of earning foreign exchange, more efficient use of domestic resources, greater prospects of growth and creation of employment opportunities. The advantages to the business firms include: prospects for higher profits, greater utilisation of production capacities, way out to intense competition in domestic market and improved business vision.

Modes of entry: A firm desirous of entering into international business has several options available to it. These range from exporting/importing to contract manufacturing abroad, licensing and franchising, joint ventures and setting up wholly owned subsidiaries abroad. Each entry mode has its own advantages and disadvantages which the firm needs to take into account while deciding as to which mode of entry it should prefer.

India's involvement in world business: Since time immemorial, India has been trading with foreign countries. Over the years, India's trade has registered spectacular growth. Currently, foreign trade accounts for about 24 per of the country's Gross Domestic Product (GDP). Textiles and garments, gems and jewellery, engineering products and chemicals and related

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products and agricultural and allied products are India's major items of exports. Important items of its imports include: crude oil and petroleum products, capital goods (i.e., machinery), electronic goods, pearls, precious and semi-precious stones, gold, silver and chemicals.

USA, UK, Belgium, Germany, Japan, Switzerland, Hong Kong, UAE, China, Singapore and Malaysia are the major trading partners. These eleven countries together accounted for about 48 per cent of India's total trade (comprising of both the exports and imports) in 2003-04.

Trade in Services: India's trade in services have also undergone significant changes over the years in terms of both the volume and composition of trade. The most conspicuous change relates to emergence of software exports which of late have to account for about 49 per cent of India's total services exports.

Data relating to India's foreign investments (both inward and outward) too show remarkable growth. While the inward foreign investments have grown more than 750 times, from just Rs. 201 crores in 1990-91 to Rs. 1,51,406 in 2003-04, India's investments abroad have increased much more exponentially, around 4,927 times, from Rs. 19 crores in 1990-91 to Rs. 83,616 crores in 2003-04.

India's performance, however, does not appear very satisfactory in terms of international comparison. India's share in world trade is a mere 0.8 per cent. Its position in respect of foreign investments too is poor. India continues to lag considerably behind other developing countries which have emerged as major destinations for foreign investments.

EXERCISES

Multiple Choice Questions

1. In which of the following modes of entry, does the domestic manufacturer give the right to use intellectual property such as patent and trademark to a manufacturer in a foreign country for a fee

   a. Licensing
   b. Contract manufacturing
   c. Joint venture
   d. None of these

2. Outsourcing a part of or entire production and concentrating on marketing operations in international business is known as

   a. Licensing
   b. Franchising
   c. Contract manufacturing
   d. Joint venture

3. When two or more firms come together to create a new business entity that is legally separate and distinct from its parents it is known as

   a. Contract manufacturing
   b. Franchising
   c. Joint ventures
   d. Licensing

4. Which of the following is not an advantage of exporting?

   a. Easier way to enter into international markets
   b. Comparatively lower risks
   c. Limited presence in foreign markets
   d. Less investment requirements

5. Which one of the following modes of entry requires higher level of risks?

   a. Licensing
   b. Franchising
   c. Contract manufacturing
   d. Joint venture

6. Which one of the following modes of entry permits greatest degree of control over overseas operations?

   a. Licensing/franchising
   b. Wholly owned subsidiary
   c. Contract manufacturing
   d. Joint venture

7. Which one of the following modes of entry brings the firm closer to international markets?

   a. Licensing
   b. Franchising
   c. Contract manufacturing
   d. Joint venture

8. Which one of the following is not amongst India's major export items?

   a. Textiles and garments
   b. Gems and jewellery
   c. Oil and petroleum products
   d. Basmati rice

9. Which one of the following is not amongst India's major import items?

   a. Ayurvedic medicines
   b. Oil and petroleum products
   c. Pearls and precious stones
   d. Machinery

10. Which one of the following is not amongst India's major trading partners?

   a. USA
   b. UK
   c. Germany
   d. New Zealand

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Short Answer Questions

1. Differentiate between international trade and international business.
2. Discuss any three advantages of international business.
3. What is the major reason underlying trade between nations?
4. Discuss as to why nations trade.
5. Enumerate limitations of contract manufacturing.
6. Why is it said that licensing is an easier way to expand globally?
7. Differentiate between contract manufacturing and setting up wholly owned production subsidiary abroad.
8. Distinguish between licensing and franchising.
9. List major items of India's exports.
10. What are the major items that are exported from India?
11. List the major countries with whom India trades.

Long Answer Questions

1. What is international business? How is it different from domestic business?
2. "International business is more than international trade". Comment.
3. What benefits do firms derive by entering into international business?
4. In what ways is exporting a better way of entering into international markets than setting up wholly owned subsidiaries abroad.
5. Discuss briefly the factors that govern the choice of mode of entry into international business.
6. Discuss the major trends in India's foreign trade. Also list the major products that India trades with other countries.
7. What is invisible trade? Discuss salient aspects of India's trade in services.