INTERNATIONAL BUSINESS AND TRADE

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PREFACE

This contemporary text book has been written to provide a comprehensive study material for the MBA and BBA students. This book is an attempt to put forth the concept in a practical, lucid, simple and succinct manner. This book is an outcome of long period of teaching the subject and is prepared with a desire to introduce the subject with clarity and in a logical sequence.

It will be more useful for Post Graduates courses like M.Com, MBA, PGDM etc and also to those pursuing different professional courses like CA, CWA, CFA etc. Practicing managers may also refer to this book for conceptual clarity. We will be incorporating case studies in our upcoming new editions shortly.

In the preparation of this text, we have consulted many authors and other publications for information on slight issues. We are highly thankful to them. We shall be failing in our duties, if we do not appreciate the contribution of our parents and other family members for their encouragement and continued support in completing this text.

No book can be perfect and this one is no exception. We shall be grateful if any imperfections, obscurities, errors and misprints are brought to our notice, so that the suggestions may be incorporated in the later editions.

We are highly thankful to Vayu Publication, who took a lot of interest in publishing this text with great interest and enthusiasm. We shall feel highly rewarded if the book fulfills the expectations of the students and learned faculty members. In order to make the book more accessible to non-finance readers the book extracts most of the technical terms from various chapters and places in the last chapter "Glossary of Financial Terms". We hope to receive deep suggestions for upcoming new next edition of this book. We shall be happy if students initiate to discuss on various issues raised in this book.

–Authors

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Chapter 1

GLOBALIZATION

1.1 INTRODUCTION

The global telecommunications industry, which was profiled in the opening case, is one industry at the forefront of this development. A decade ago most national telecommunications markets were dominated by state-owned monopolies and isolated from each other by substantial barriers to cross-border trade and investment.

This is rapidly becoming a thing of the past. A global telecommunications market is emerging. In this new market, prices are being bargained down as telecommunications providers compete with each other around the world for residential and business customers. The big winners are the customers, who should see the price of telecommunications services plummet, saving them billions of dollars. The rapidly emerging global economy raises a multitude of issues for businesses both large and small. It creates opportunities for businesses to expand their revenues, drive down their costs, and boost their profits started accompany to manufacture it, and has now sold the mouse to consumers worldwide, using the Internet as his distribution channel.

1.2 WHAT IS GLOBALIZATION

1. **The Globalization of Markets:** The **globalization of markets** refers to the merging of historically distinct and separate national markets into one huge global marketplace. It has been argued for some time that the tastes and preferences of consumers' indifferent nations are beginning to converge on some global norm, thereby helping to create a global market. The global acceptance of consumer products such as Citicorp credit cards, Coca-Cola…. By offering a standardized product worldwide, they are helping to *create* a global market. A company does not have to be the size of these multinational giants to facilitate, and benefit from, the globalization of markets.

In the case of many products, these differences frequently require that marketing strategies, product features, and operating practices be customized to best match conditions in a country. Thus different car models depending on a whole range of factors such as local fuel costs, income levels, traffic congestion, and cultural values. The most global markets currently are not markets for consumer products—where national differences in tastes and preferences are still often important enough to act as a brake on globalization—but markets for industrial goods and materials that serve a universal need the world over. These include the markets for commodities such as aluminium, oil, and wheat, the markets for industrial products such as microprocessors. In many global markets, the same firms frequently confront each other as competitors in nation after nation.

2. **The Globalization of Production:** The **globalization of production** refers to the tendency among firms to source goods and services from locations around the globe to take advantage of national differences in the cost and quality of factors of production. By doing so, companies hope to lower their overall cost structure or improve the quality or functionality of their product offering, thereby allowing them to compete more effectively. The result of having a *global web* of suppliers is a better final product, which enhances the chances of Boeing winning a greater share of total orders for aircraft than its global rival, Airbus. Boeing also out sources some production to foreign Countries to increase the chance that it will win significant orders from airliners based in that country. The global dispersal of productive activities is not limited to giants such as Boeing. Many much smaller firms are also getting into the act. Nevertheless, we are travelling down the road toward a future characterized by the increased globalization of markets and production. Modern firms are important actors in this drama, fostering by their very actions increased globalization. These firms, however, are merely responding in an efficient manner to changing conditions in their operating environment—as well they should. In the next section, we look at the main drivers of globalization.
3. **Technology Improvement:** Improved information processing and communication allow firms to have better information about distant markets and coordinate activities worldwide. The explosive growth of the World Wide Web and the Internet provide a means to rapid communication of information and the ability of firms and individuals to find out about what is going on worldwide for a fraction of the cost and hassle as was required only a couple of years ago.

Improvements in transportation technology, including jet transport, temperature controlled containerized shipping, and coordinated ship-rail-truck systems have made firms better able to respond to international customer demands. As a consequence of these trends, a manager in today's firm operates in an environment that offers

more opporties, but is also more complex and competitive than that faced a generation ago.

People now work with individuals and companies from many countries, and while communications technology, with the universality of English as the language of business, has decreased the absolute level of cultural difficulties individuals face, the frequency with which they face inter-cultural and international challenges has increased. Exports are goods and services produced in one country and then sent to another country. Imports are goods and services produced in one country and then brought in by another country. Information about exports and imports helps us to explain the impact of international business on the economy.

1. Foreign direct investment (FDI) is equity funds invested in other nations. Industrialized countries have invested large amounts of money in other industrialized nations and smaller amounts in less developed countries (LDCs), such as those in Eastern Europe, or in newly industrialized countries (NICs), such as Hong Kong, South Korea, and Singapore. Most of the world's FDI is in the US, the European Union (EU), and Japan. As nations have become more affluent, they have pursued FDI in geographic areas that have economic growth potential. The Japanese, for example, have been investing heavily in the EU in recent years.
2. Over 50 per cent of world trade and over 80 per cent of foreign direct investment is conducted by three regional economic hubs: the US, the EU and Japan. Collectively, these areas are referred to as the "triad". The triad is a group of three major trading and investment blocs in the international arena.

1.3 TODAY'S GLOBAL ENVIRONMENT

Over the last few decades an increasing number of countries have embraced trade and investment liberalization. Notwithstanding, triad countries have often had disagreements about implementation. A number of mechanisms to solve disputes among countries have evolved; the main one is the World Trade Organization (WTO), established in 1995. Today, the WTO is the umbrella organization that governs the international trading system. When member countries have a dispute they turn to the WTO's dispute-settlement mechanism to help resolve it. For example, the US and the EU have brought cases against each other in such matters as banana imports, beef hormones, steel, and foreign sales corporations. The WTO can enforce its decisions. Countries that refuse to comply can find themselves suffering severe consequences in the form of trade retaliation.

Technology is having a major impact on the way multinational enterprises MNEs do business. Over the last few years, communication technology has allowed all business to use computers, mobile phones and to rely on the World Wide Web to access and send information. New technological developments have also been

applied to the production of goods and services. Companies can now implement quality programs and improve manufacturing flexibility, among other things.

International business is not limited to giant multinational enterprises. Many small and medium-sized businesses are also involved in this arena. These include service industries, which currently employ about 70 per cent of all workers in the US and Canada.

1.4 GLOBALIZATION AND STRATEGIC MANAGEMENT

A. A common misconception about international business is that MNEs have far-flung operations and earn most of their revenues overseas. In fact, most MNEs earn the bulk of their revenues either within their home country or by selling in nearby locales. Of the largest 500 MNEs, 198 are headquartered in North America, 156 are in the EU and 125 are in Japan/Asia. These firms are not spread around the world but are clustered in the triad and engage in triad/regional competition. MNEs do not develop homogeneous products for the world market but must adapt their product to local markets. For example, there is no global car but regional-based auto factories that are supported by regional/local suppliers and design cars to meet the preferences of local/regional customers.

B. There are three things a nation must do to gain and hold strong international trading and investment positions: (a) maintain economic competitiveness; (b) influence trade regulations so that other countries open their doors for its goods and services; and (c) develop a global orientation that allows firms to operate as MNEs, not just as local firms doing business overseas.

C. Research shows that the best way for companies to achieve competitive advantage is through innovation. Often this is accomplished through ongoing improvement of goods or services. A second way is by making existing products obsolete, by developing new and better products that replace old ones.

D. Why can some firms innovate consistently while others cannot? According to Porter, the answer rests in four broad attributes that individually and interactively determine national competitive advantage: factor conditions, demand conditions, related and supporting industries, and firm strategy, structure and rivalry.

E. Factor conditions include land, labor, and capital that are used to develop international marketniches and tap world markets. Demand conditions require a sophisticated local demand that helps businesses fashion and shape the goods and services that will later be offered on the world market. Related and supporting industries help MNEs remain abreast of low-cost inputs and knowledge regarding what is happening in their industry. Firm strategy,

structure, and rivalry help organizations create, organize, and manage their operations in the face of competitiveness.

F. Each of the four determinants in Porter's model often depends on the others. For example, if a country has sophisticated buyers that can provide a company with feedback regarding how to modify or improve its product (demand conditions), this information will not be useful if the firm lacks personnel with the skills to carry out these functions (factor conditions). Similarly, if suppliers can provide the company with low-cost inputs and fresh ideas for innovation (related and supporting industries), but the firm clearly and easily dominates the industry (firm strategy, structure, and rivalry) and does not feel a need to upgrade the quality of its products and services, it will eventually lose this competitive advantage.

G. Porter notes that government and chance influence the four determinants. Government policies, for example, can have serious consequences for international trade, since government intervention for the purpose of protecting home industries usually results in less competitive national companies. There is often strong domestic pressure to provide such protection. Yet research shows that a government's major role in international business may well be that of world trade negotiator.

H. Many companies do business in other countries, but they have not developed the needed international perspective. This requires attention in three areas: experience, focus, and attitude. One way to create an international perspective is to hire individuals with international experience. A second way is to emphasize the importance of international activities. A third way is to change the attitudes that many managers have toward their work.

1.5 THE CHANGING DEMOGRAPHICS OF THE GLOBAL

The U.S. share of world output has declined dramatically in the past 30 years, and a much more balanced picture is now developing among industrialized countries. Looking ahead into the next century, the share of world output of what are now referred to as "developing countries" is expected to greatly surpass that of the current "industrialized countries."

The changing demographics of the global economy:

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2. The source and destinations of FDI has also dramatically changed over recent years, with the US and industrialized countries becoming less important

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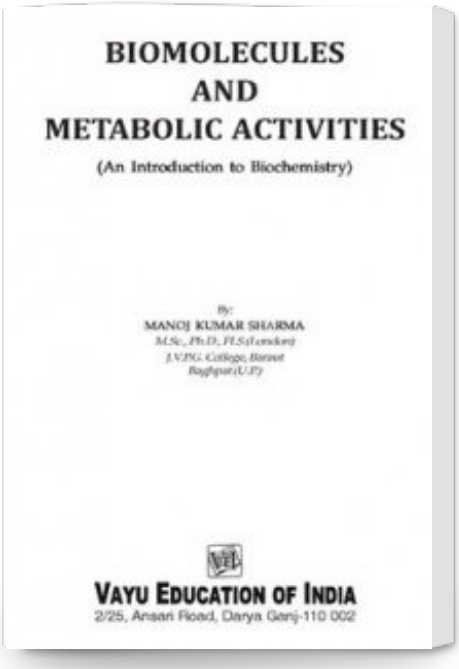

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