MODULE- I:

INTRODUCTION TO INTERNATIONAL BUSINESS

International Business

International business encompasses all commercial activities that take place to promote the transfer of goods, services, resources, people, ideas, and technologies across national boundaries.

International Business refers to the global business where goods and services are exchanged between countries. It involves transfer of goods, services, information, resources, capital etc.

International business comprises of all commercial transactions that take place between two or more countries beyond their political boundaries. These transactions may take place between private companies or governments of different countries.

Apart from individual firms, governments and international agencies may also get involved in international business transactions. Companies and countries may exchange different types of physical and intellectual assets. These assets can be products, services, capital, technology, knowledge, or labor.

There are five major reasons why a business may want to go global −

- **First-mover Advantage** − It refers to getting into a new market and enjoy the advantages of being first. It is easy to quickly start doing business and get early adopters by being first.
- **Opportunity for Growth** − Potential for growth is a very common reason of internationalization. Your market may saturate in your home country and therefore you may set out on exploring new markets.
- **Small Local Markets** − Start-ups in Finland and Nordics have always looked at internationalization as a major strategy from the very beginning because their local market is small.
- **Increase of Customers** − If customers are in short supply, it may hit a company's potential for growth. In such a case, companies may look for internationalization.
- **Discourage Local Competitors** − Acquiring a new market may mean discouraging other players from getting into the same business-space as one company is in.

Advantages of Internationalization

There are multiple advantages of going international. However, the most striking and impactful ones are the following four.

1. **Product Flexibility: -** International businesses having products that don't really sell well enough in their local or regional market may find a much better customer base in international markets. Hence, a business house having global presence need not dump the unsold stock of products at deep discounts in the local market. It can search for some new markets where the products sell at a higher price.

   A business having international operations may also find new products to sell internationally which they don't offer in the local markets. International businesses have a wider audience and thus they can sell a larger range of products or services.
2. **Less Competition: -** Competition can be a local phenomenon. International markets can have less competition where the businesses can capture a market share quickly. This factor is particularly advantageous when high-quality and superior products are available. Local companies may have the same quality products, but the international businesses may have little competition in a market where an inferior product is available.
3. **Protection from National Trends and Events: -** Marketing in several countries reduces the vulnerability to events of one country. For example, the political, social, geographical and religious factors that negatively affect a country may be offset by marketing the same product in a different country. Moreover, risks that can disrupt business can be minimized by marketing internationally.
4. **Learning New Methods: -** Doing business in more than one country offers great insights to learn new ways of accomplishing things. This new knowledge and experience can pave ways to success in other markets as well.

Importance of International Business

1. **Earn foreign exchange**: International business exports its goods and services all over the world. This helps to earn valuable foreign exchange. This foreign exchange is used to pay for imports. Foreign exchange helps to make the business more profitable and to strengthen the economy of its country.
2. **Optimum utilisation of resources**: International business makes optimum utilisation of resources. This is because it produces goods on a very large scale for the international market. International business utilises resources from all over the world. It uses the finance and technology of rich countries and the raw materials and labour of the poor countries.
3. **Achieve its objectives**: International business achieves its objectives easily and quickly. The main objective of an international business is to earn high profits. This objective is achieved easily. This it because it uses the best technology. It has the best employees and managers. It produces high-quality

goods. It sells these goods all over the world. All this results in high profits for the international business.

4. **To spread business risks**: International business spreads its business risk. This is because it does business all over the world. So, a loss in one country can be balanced by a profit in another country. The surplus goods in one country can be exported to another country. The surplus resources can also be transferred to other countries. All this helps to minimise the business risks.
5. **Improve organisation's efficiency**: International business has very high organisation efficiency. This is because without efficiency, they will not be able to face the competition in the international market. So, they use all the modern management techniques to improve their efficiency. They hire the most qualified and experienced employees and managers. These people are trained regularly. They are highly motivated with very high salaries and other benefits such as international transfers, promotions, etc. All this results in high organisational efficiency, i.e. low costs and high returns.
6. **Get benefits from Government**: International business brings a lot of foreign exchange for the country. Therefore, it gets many benefits, facilities and concessions from the government. It gets many financial and tax benefits from the government.
7. **Expand and diversify**: International business can expand and diversify its activities. This is because it earns very high profits. It also gets financial help from the government.
8. **Increase competitive capacity**: International business produces high-quality goods at low cost. It spends a lot of money on advertising all over the world. It uses superior technology, management techniques, marketing techniques, etc. All this makes it more competitive. So, it can fight competition from foreign companies.

Various concepts involved in it such as:

1. **Entrepot Trade**: - The term entrepôt, also called a transshipment port and historically referred to as a port city, is a trading post, port, city, or warehouse where merchandise may be imported, stored, or traded before re-export, with no additional processing taking place and with no customs duties imposed.

   In other words, entrepot trade is a process in which goods are imported in one country with the express purpose of having them end up in a different country. In a case like this, a trader becomes both the importer and the exporter of these goods.

   In the past, entrepots enabled merchants to utilize part of a trade route to sell their goods without having to bear the risks and costs associated with long-distance travel over the entire route.

   The use of trade entrepôts has become largely obsolete as fast, efficient, and safe transportation options have become increasingly cost-effective.

Nevertheless, entrepôts trade still occurs sometimes among Asian markets such as Hong Kong or Singapore.

For example, if a South African company were to import wool from Australia and export it immediately to Zimbabwe, this would be called entrêpot trade for South Africa.

Breaking Down Entrepot

Entrepôts were usually ports located at strategic points along the sea trade routes. Entrepôts flourished during the age of colonialism, when ships would travel long distances to bear goods such as commodities and spices from the colonies in the Americas and Asia back to Europe. The benefit of the entrepôt in the past was that it removed the need for ships to travel the whole distance of the shipping route. Ships would sell their goods into the entrepôt and the entrepôt would, in turn, sell them to another ship traveling a further leg of the route.

Using Trade Entrepots Today

The use of trade entrepôts has become largely obsolete as transportation options and safety have improved, and as the establishment of customs areas in seaports and airports have negated the financial benefits of entrepôts (goods in customs areas are stored for re-export and because they do not technically enter the country in which they are located, no customs duties are charged). However, entrepôt trade has continued in some regions. In particular, Hong Kong and Singapore have remained centers of entrepôt trade through the twentieth century and beyond.

2. **<u>Tariff Barriers</u>**

Term tariff means ‘Tax’ or ‘duty’. Tariff barriers are the ‘tax barriers’ or the ‘monetary barriers’ imposed on internationally traded goods when they cross the national borders.

Types of Tariff barriers:

a) **Specific duty:** It is based on the physical characteristics of the good. A fixed amount of money can be levied on each unit of imported goods regardless of its price. Eg. Imposing of $15 on an imported shoe.

b) **Ad Valorem tariffs:** The Latin phrase ‘ad valorem’ means “according to the value”. This tax is flexible and depends upon the value or the price of the commodity. An example of an ad valorem tariff would be a 15% tariff levied by Japan on U.S. automobiles. The 15% is a price increase on the value of the automobile, so a $10,000 vehicle now costs $11,500 to Japanese consumers.

This price increase protects domestic producers from being undercut but also keeps prices artificially high for Japanese car shoppers.

c) **Combined or compound duty:** It is a combination of specific and ad valorem duty on a single product, for instance , there can be a combined duty when 10% of value(ad valorem) and 1$ per kilogram(specific tax) are charged on metal M.

d) **Countervailing duty:** It is imposed on certain import where it is being subsidised by exporting governments. As a result of the government subsidy, imports become more cheaper than domestic goods, to nullify the effect of subsidy, this duty is imposed in addition to normal duties.

e) **Revenue tariff:** A tariff which is designed to provide revenue or income to the home government is known as revenue tariff. Generally this tariff is imposed with a view of earning revenue by imposing duty on consumer goods, particularly on luxury goods whose demand from the rich is inelastic.

f) **Anti –dumping duty:** At times exporters attempt to capture foreign markets by selling goods at rock-bottom prices, such practice is called dumping. As a result of dumping, domestic industries find it difficult to compete with imported goods. To offset anti-dumping effects, duties are levied in addition to normal duties.

g) **Protective tariff:** In order to protect domestic industries from stiff competition of imported goods, protective tariff is levied on imports. Normally a very high duty is imposed, so as to either discourage imports or to make the imports more expensive as that of domestic products.

h) **Import tariffs:** Taxes on goods that are imported into a country. They are more common than export tariffs.

i) **Export tariffs:** Taxes on goods that are leaving a country. This may be done to raise tariff revenue or to restrict world supply of a good.

3. Non-Tariff Barriers to Trade

A nontariff barrier is a way to restrict trade using trade barriers in a form other than a tariff. Nontariff barriers include quotas, embargoes, sanctions, and levies. As part of their political or economic strategy, large developed countries frequently use nontariff barriers to control the amount of trade they conduct with other countries.

Countries commonly use nontariff barriers in international trade, and they typically base these barriers on the availability of goods and services and political alliances with trading countries. Overall, any barrier to international trade will influence the economy because it limits the functions of standard market trading.

Types of Non-Tariff Barriers

1. Quota System: Under this system, a country may fix in advance, the limit of import quantity of a commodity that would be permitted for import from various countries during a given period. The quota system can be divided into the following categories:

(a) Tariff/Customs Quota (b) Unilateral Quota

(c) Bilateral Quota (d) Multilateral Quota

- **Tariff/Customs Quota:** Certain specified quantity of imports is allowed at duty free or at a reduced rate of import duty. Additional imports beyond the specified quantity are permitted only at increased rate of duty. A tariff quota, therefore, combines the features of a tariff and an import quota.
- **Unilateral Quota:** The total import quantity is fixed without prior consultations with the exporting countries.
- **Bilateral Quota:** In this case, quotas are fixed after negotiations between the quota fixing importing country and the exporting country.
- **Multilateral Quota:** A group of countries can come together and fix quotas for exports as well as imports for each country.

2. Sanctions: - Countries impose sanctions on other countries to limit their trade activity. Sanctions can include increased administrative actions or additional customs and trade procedures that slow or limit a country's ability to trade.

3. Product Standards: Most developed countries impose product standards for imported items. If the imported items do not conform to established standards, the imports are not allowed. For instance, the pharmaceutical products must conform to pharmacopoeia standards.

4. Domestic Content Requirements: Governments impose domestic content requirements to boost domestic production. For instance, in the US bailout package (to bailout General Motors and other organisations), the US Govt. introduced 'Buy American Clause' which means the US firms that receive bailout package must purchase domestic content rather than import from elsewhere.

5. Product Labelling: Certain nations insist on specific labeling of the products. For instance, the European Union insists on product labeling in major languages spoken in EU. Such formalities create problems for exporters.

6. Packaging Requirements: Certain nations insist on particular type of packaging materials. For instance, EU insists on recyclable packing materials, otherwise, the imported goods may be rejected.

7. Other Non-Tariff Barriers: There are a number of other non – tariff barriers such as health and safety regulations, technical formalities, environmental regulations, embargoes, etc.

REGIONAL TRADING BLOCS

Regional Trade Blocs or Regional Trade Agreements (or Free Trade Agreements) are a type of regional intergovernmental arrangement, where the participating countries agree to reduce or eliminate barriers to trade like tariffs and non-tariff barriers. The RTBs are thus historically known for promoting trade within a region by reducing or eliminating tariff among the member countries.

A regional trading bloc (RTB) is a co-operative union or group of countries within a specific geographical boundary. RTB protects its member nations within that region from imports from the non-members. Trading blocs are a special type of economic integration.

Ttypes of trading blocs −

- **Preferential Trade Area** − Preferential Trade Areas (PTAs), the first step towards making a full-fledged RTB, exist when countries of a particular geographical region agree to decrease or eliminate tariffs on selected goods and services imported from other members of the area.

  Here, two or more countries form a trading club or a union and reduce tariffs on imports of each other ie, when they exchange tariff preferences and concessions.

- **Free Trade Area** − Free Trade Areas (FTAs) are like PTAs but in FTAs, the participating countries agree to remove or reduce barriers to trade on all goods coming from the participating members.

  Member countries abolish all tariffs within the union, but maintain their individual tariffs against the rest of the world.

- **Customs Union** − A customs union has no tariff barriers between members, plus they agree to a common (unified) external tariff against non-members. Effectively, the members are allowed to negotiate as a single bloc with third parties, including other trading blocs, or with the WTO.

  Customs union: countries abolish all tariffs within and adopt a common external tariff against the rest of the world.

- **Common Market** − A ‘common market’ is an exclusive economic integration. The member countries trade freely all types of economic resources – not just tangible goods. All barriers to trade in goods, services, capital, and labor are removed in common markets. In addition to tariffs, non-tariff barriers are also diminished or removed in common markets.

  In addition to the customs union, unrestricted movement of all factors of production including labour between the member countries. In the case of European Common Market, once a visa is obtained one can get employed in France or Germany or in any other member country with limited restrictions.

- **Economic union:** The Economic Union is the highest form of economic co-operation. In addition to the common market, there is common currency, common fiscal and monetary policies and exchange rate policies etc. European Union is the example for an Economic Union. Under the European Monetary Union, there is only one currency- the Euro.

Regional Trading Blocs – Advantages

The advantages of having a Regional Trading Bloc are as follows −

- **Foreign Direct Investment** − Foreign direct investment (FDI) surges in TRBs and it benefits the economies of participating nations.
- **Economies of Scale** − The larger markets created results in lower costs due to mass manufacturing of products locally. These markets form economies of scale.
- **Competition** − Trade blocs bring manufacturers from various economies, resulting in greater competition. The competition promotes efficiency within firms.
- **Trade Effects** − As tariffs are removed, the cost of imports goes down. Demand changes and consumers become the king.
- **Market Efficiency** − The increased consumption, the changes in demand, and a greater amount of products result in an efficient market.

Regional Trading Blocs – Disadvantages

The disadvantages of having a Regional Trading Bloc are as follows −

- **Regionalism** − Trading blocs have bias in favor of their member countries. These economies establish tariffs and quotas that protect intra-regional trade from outside forces. Rather than following the World Trade Organization, regional trade bloc countries participate in regionalism.
- **Loss of Sovereignty** − A trading bloc, particularly when it becomes a political union, leads to partial loss of sovereignty of the member nations.
- **Concessions** − The RTB countries want to let non-member firms gain domestic market access only after levying taxes. Countries that join a trading bloc needs to make some concessions.
- **Interdependence** − The countries of a bloc become interdependent on each other. A natural disaster, conflict, or revolution in one country may have adverse effect on the economies of all participants.

Trade agreement

Any contractual arrangement between states concerning their trade relationships. Trade agreements may be bilateral or multilateral—that is, between two states or more than two states. A **trade agreement** (also known as **trade pact**) is a wide-ranging taxes, tariff and trade treaty that often includes investment guarantees. It exists when two or more countries agree on terms that help them trade with each other. The most common trade agreements are of the preferential and free trade types, which are concluded in order to reduce (or eliminate) tariffs, quotas and other trade restrictions on items traded between the signatories.

Importance of Trade Agreement

1. **Reduce trade barriers**

   – For most countries international trade is regulated by unilateral barriers of several types:

   - Tariffs
   - Nontariff barriers

   – Two or more nations can go for economic integration by partial or full abolition of these barriers importance of trade agreements

   - Trade agreements are one way to reduce these barriers, thereby opening all parties to the benefits of increased trade

   - In most modern economies the possible coalitions of interested groups are numerous, and the variety of possible unilateral barriers is great 5

2. **Increase the combined economic productivity**

   – It increase the combined economic productivity of the countries by economic cooperation

   – International trade, allows each country to specialize in the goods it can produce cheaply and efficiently relative to other countries

   – Specialization enables all countries to achieve higher real incomes 6

3. **Trade agreements bring many benefits for economies around the world**

   -New markets

   -Jobs

   -Competitiveness

   -Foreign investment

   ➢ **New markets**

   - Trade liberalization opens new markets between trade partners
   - Free trade zones allow exports to grow

   ➢ **Jobs**

   - Trade Agreements can create jobs and help to grow the economy
   - Most of jobs depend on exports

- **Foreign investment**
  - Free trade agreements spawn foreign investment, creating economic growth
  - As markets open for each of the trade partners so does investment opportunities
- **Competitiveness**
  - Free trade agreements increase industry
  - competitiveness and the expansion of exports
  - Competition from abroad forces domestic producers to keep prices down

TYPES of Trade Agreements

A trade agreement is an accord between two or more countries for a specific term of trade, commerce, transit or investment. They mostly involve mutually beneficial concessions. Trade agreements are usually unilateral, bilateral, or multilateral.

Unilateral Trade Agreement

These occur when a country imposes trade restrictions and no other country reciprocates. A country can also unilaterally loosen trade restrictions, but that rarely happens because it would put the country at a competitive disadvantage. The United States and other developed countries only do this as a type of foreign aid in order to help emerging markets strengthen strategic industries that are too small to be a threat. It helps the emerging market's economy grow, creating new markets for U.S. exporters.[1]

Bilateral Trade Agreements

Bilateral agreements involve two countries. Both countries agree to loosen trade restrictions to expand business opportunities between them. They lower tariffs and confer preferred trade status on each other. The sticking point usually centers around key protected or government-subsidized domestic industries. For most countries, these are in the automotive, oil, or food production industries. The Obama administration was negotiating the world's largest bilateral agreement, the Transatlantic Trade and Investment Partnership with the European Union, but this stalled under the Trump administration.

Multilateral Trade Agreements

These agreements among three countries or more are the most difficult to negotiate. The greater the number of participants, the more difficult the negotiations are. By nature, they are more complex than bilateral agreements, as each country has its own needs and requests.

Once negotiated, multilateral agreements are very powerful. They cover a larger geographic area, which confers a greater competitive advantage on the signatories. All countries also give each other most-favored-nation status—granting the best mutual trade terms and lowest tariff.

Depending on the terms and concession agreed on by the participating bodies, there are several types of trade agreements- **(The Indian Perspective)**

- **Free Trade Agreement: -** A free trade agreement is an agreement in which two or more countries agree to provide preferential trade terms, tariff concession etc. to the partner country. Here a negative list of products and services is maintained by the negotiating countries on which the terms of FTA are not applicable hence it is more comprehensive than preferential trade agreement. India has negotiated FTA with many countries e.g. Sri Lanka and various trading blocs as well e.g. ASEAN.
- **Preferential Trade Agreement: -** In this type of agreement, two or more partners give preferential right of entry to certain products. This is done by reducing duties on an agreed number of tariff lines. Here a positive list is maintained i.e. the list of the products on which the two partners have agreed to provide preferential access. Tariff may even be reduced to zero for some products even in a PTA. India signed a PTA with Afghanistan.
- **Comprehensive Economic Partnership Agreement: -** Partnership agreement or cooperation agreement are more comprehensive than an FTA. CECA/CEPA also looks into the regulatory aspect of trade and encompasses and agreement covering the regulatory issues. CECA has the widest coverage. CEPA covers negotiation on the trade in services and investment, and other areas of economic partnership. It may even consider negotiation on areas such as trade facilitation and customs cooperation, competition, and IPR.
  India has signed CEPAs with South Korea and Japan.
- **Comprehensive Economic Cooperation Agreement: -** CECA generally covers negotiation on trade tariff and TQR rates only. It is not as comprehensive as CEPA. India has signed CECA with Malaysia.
- **Framework agreement: -** Framework agreement primarily defines the scope and provisions of orientation of the potential agreement between the trading partners. It provides for some new area of discussions and set the period for future liberalisation. India has previously signed framework agreements with the ASEAN, Japan etc.
- **Early Harvest Scheme: -** An Early Harvest Scheme (EHS) is a precursor to an FTA/CECA/CEPA between two trading partners. For example early harvest scheme of RCEP has been rolled out. At this stage, the negotiating countries identify certain products for tariff liberalization pending the conclusion

of actual FTA negotiations. An Early Harvest Scheme is thus a step towards enhanced engagement and confidence building.

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