Chapter 1

Introduction to International Business

International Business
Strategy Management & the New Realities

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Learning Objectives

1. What is international business?
2. What are the key concepts in international trade and investment?
3. How does international business differs from domestic business?
4. Who participates in international business?
5. Why do firms pursue internationalization strategies?
6. Why should you study international business?

International Business – A Firm Level Activity

Performance of trade and investment activities by firms across national borders.

Internationalization of Business

- Companies conduct value-adding activities on a *global* scale, i.e. organize, source, manufacture, market, etc.
- Firm's international expansion is made more compelling and easier due to market and product globalization- for firms small and large.
- A "level playing field" has made cross-border activities appealing to all types of firms- large and small; manufacturing and service sectors (e.g. banking, transportation, engineering and design, advertising, and retailing).

The Nature of International Business

- All value-adding activities including sourcing, manufacturing, and marketing, can be performed in international locations
- The subject of cross-border trade can be products, services, capital, technology, know how, and labor
- Firms internationalize through exporting, foreign direct investment, licensing, franchising, and collaborative ventures

Globalization of Markets – a Macro Concept

Ongoing economic integration and growing interdependency of countries worldwide.

- Integration is central to globalization, which has resulted in the widespread diffusion of products, technology, and knowledge worldwide, regardless of where they originate.

Dimensions of Market Globalization

- Greater integration and interdependency of national economies; leading to freer movement of goods, services, capital, and knowledge
- Rise of regional economic integration blocs
- Growth of global investment and financial flows
- Convergence of consumer lifestyles and preferences
- Globalization of production

International Trade

Exchange of products and services across national borders; typically through exporting and importing.

Exporting

Sale of products or services to customers located abroad, from a base in the home country or a third country.

Importing or Global Sourcing

Procurement of products or services from suppliers located abroad for consumption in the home country or a third country.

International investment

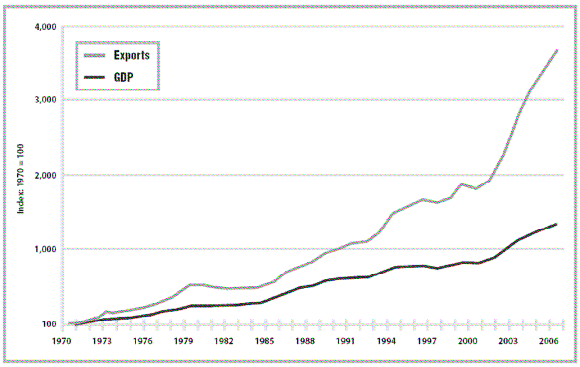
Transfer of assets to another country or the acquisition of assets in that country.

- ***International Portfolio investment*** (typically short-term) is the passive ownership of foreign securities such as stocks and bonds for the purpose of generating financial returns.
- ***Foreign direct investment*** (FDI) (typically long-term) is an internationalization strategy in which the firm establishes a physical presence abroad through acquisition of productive assets such as capital, technology, labor, land, plant, and equipment.

World Trade Is Growing Faster than GDP

- The exponential growth of cross-border trade relative to world GDP is due in part to advanced economies such as Canada and Japan sourcing to low-cost locations, e.g. China and Mexico.
- The rapid integration of world economies is fueled by factors such as the decline of trade barriers, e.g. tariffs, liberalization of markets, privatization and the economic vitality of emerging markets.

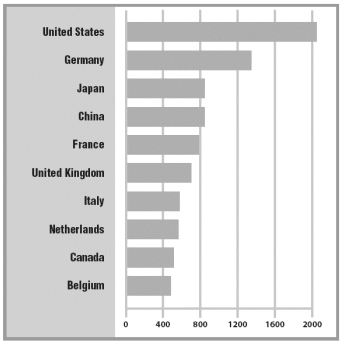
Comparing the Growth Rates of World GDP and World Exports



Leading Countries in International Merchandise Trade

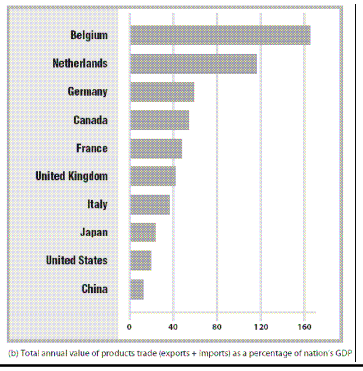
- The U.S. is the leading country in terms of the absolute value of total merchandise trade, yet, it only accounts for 19 percent of the U.S. GDP.
- For other economies, merchandise trade is a much larger component of economic activity: e.g. Belgium (167 percent), Netherlands (117 percent), and Germany (59 percent).

Leading Countries in International Merchandise Trade



(a) Total annual value of products trade (exports + imports) in billions of U.S. dollars

Leading Countries in International Merchandise Trade (2)



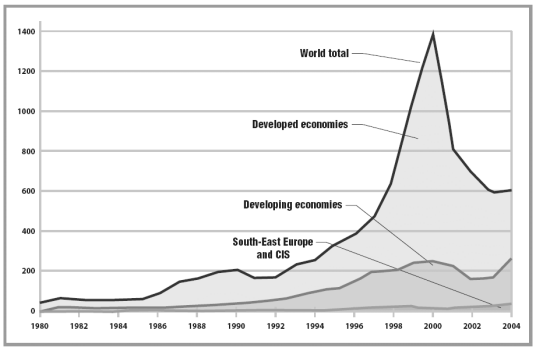
The Nature of FDI

- Foreign Direct Investment (FDI) - (asset ownership and long time frame) is the ultimate commitment-level of internationalization, and thus this text focuses primarily on FDI as opposed to International Portfolio investment.
- Large, resourceful companies with substantial international operations are able to leverage FDI to:
  - Manufacture/assemble products in low-cost labor countries, i.e. India, Russia, Brazil, China, and Mexico;
  - Invest in western markets, even though they may originate from emerging economies themselves.

Dramatic Growth of FDI Since the 1980s

- September 11, 2001 interrupted FDI inflows with the worldwide panic that ensued following the terrorist attacks in the United States.
- ***Developed economies*** = Australia, Canada, Japan, the United States, and most countries in Western Europe.
- ***Developing economies*** = Parts of Africa, Asia, and Latin America. Of particular significance is the growth of FDI into developing economies despite widespread poverty and less investment capital than advanced economies.
- The improved lives of billions are directly linked to world trade and investment.

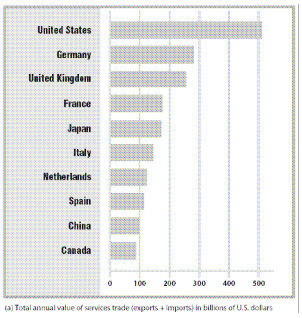
Foreign Direct Investment (FDI) Inflows into World Regions
(in Billions of U.S. Dollars per Year)



International Services Trade

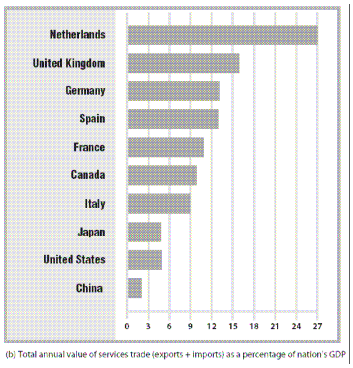
- Larger, developed economies account for the greatest proportion of services.
- EBay- the largest auction-based retailer on the Internet, earned $6 billion in 2006, 40 percent of which came from international sales.
- China has 1.3 billion people with an estimated 132 million Internet users.
- India has 1 billion people with an estimated 40 million Internet users.
- U.S. has an estimated 210 million Internet users.
- EBay expanded to India, China, Korea, and Europe in anticipation of most of its future revenue growth coming from abroad.

Leading Countries in International Services Trade



(a) Total annual value of services trade (exports + imports) in billions of U.S. dollars

Leading Countries in International Services Trade (2)



(b) Total annual value of services trade (exports + imports) as a percentage of nation's GDP

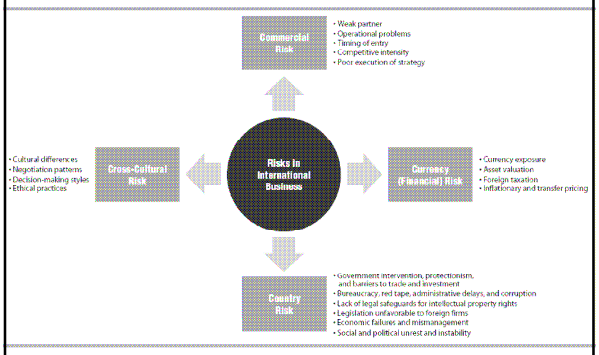
International Financial Services Sector

- **Banking** and **financial services** are the most active cross-border services.
- Explosive growth of global capital markets is due to:
  - Money → internationally into portfolio investments and pension funds
  - Banks/financial institutions internationalization → increased amount of cheap, local investment capital, stimulating local financial markets and encouraging savings.
- International banking is prospering- return on equity:
  - Saudi Arabia exceeds 20 percent; U.S. it is 15 percent
- Citibank, Deutsche Bank, BNP Paribas, and other international banks are thriving because of high oil prices, booming consumer banking, and low taxes.
- Banks bypass Islamic rules against paying interest by structuring loans as partnerships.

Service Industry Sectors That Are Rapidly Internationalizing

Industry	*Representative Activities*	*Representative Companies*
Architectural, construction, and engineering	Construction, electric power utilities, design, engineering services for airports, hospitals, dams	ABB, Bechtel Group, Halliburton, Kajima, Philip Holzman, Skanska AB
Banking, finance, and insurance	Banks, insurance, risk evaluation, management	Citigroup, CIGNA, Barclays, HSBC, Ernst & Young
Education, training, and publishing	Management training, technical training, English language training	Berlitz, Kumon Math & Reading Centers, NOVA, Pearson, Elsevier
Entertainment	Movies, recorded music, Internet- based entertainment	Time Warner, Sony, Virgin, MGM
Information services	E-commerce, e-mail, funds transfer, data interchange, data processing, network services, professional computer services	Infosys, EDI, Hitachi, Qualcomm, Cisco
Professional business services	Accounting, advertising, legal, management consulting	Leo Burnett, EYLaw, McKinsey, A.T. Kearney, Booz Allen Hamilton, Cap Gemini
Transportation	Aviation, ocean shipping, railroads, trucking, airports	Maersk, Sante Fe, Port Authority of New Jersey, SNCF (French railroads)
Travel and tourism	Transportation, lodging, food and beverage, recreation, travel on aircraft, ocean carriers, and railways	Carlson Wagonlit, Marriott, British Airways

The Four Risks of International Business



The Four Types of Risks in IB

- **Cross-cultural risk:** a situation or event where a cultural miscommunication puts some human value at stake
- **Country risk**: potentially adverse effects on company operations and profitability holes by developments in the political, legal, and economic environment in a foreign country
- **Currency risk:** risk of adverse unexpected fluctuations in exchange rates
- **Commercial risk:** firms potential loss or failure from poorly developed or executed business strategies, tactics, or procedures

Cross-Cultural Risk

- Differences in language, lifestyles, attitudes, customs, and religion, where a cultural miscommunication jeopardizes a culturally-valued mindset or behavior.
- Cultural blunders- hinder the effectiveness of foreign managers.
- Language- critical dimension of culture- a window to people's values
- Language differences impede effective communication.
- Cultural differences may lead to suboptimal business strategies.

Country Risk (Political Risk)

- Differences in host country political, legal and economic regimes may adversely impact firm profitability.
- Laws, regulations and indigenous factors e.g., property rights, intellectual-property protection, product liability, taxation policies, inflation, national debt, and unbalanced international trade, may encumber firm operations and performance.
- Government intervention: restricts market access; imposes bureaucratic procedures hindering business transactions; and limits the amount of earned income that firms may repatriate from foreign operations.

Currency Risk (Financial Risk)

- Risk of adverse exchange rate fluctuations, inflation and other harmful economic conditions create uncertainty of returns.
- When currencies fluctuate significantly, the value of the firm's assets, liabilities and/or operating income may be substantially reduced.

Commercial Risk

- Less than optimal formulation and/or implementation of strategies, tactics or procedures, e.g. partnering selections, market entry timing, pricing, product features, and promotional themes
- Failures in international markets are far more costly than domestic business blunders.

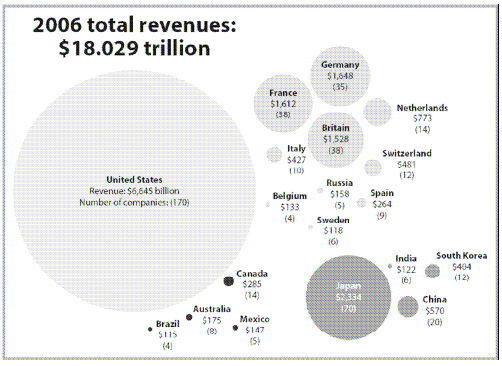
Risks: Always Present but Manageable

- Managers need to understand their implications, anticipate them, and take proactive action to reduce adverse effects.
- Some risks are extremely challenging, e.g., the East Asian economic crisis of 1998 generated substantial commercial, currency, and country risks- several East Asian countries lost currency values of between 35 and 70 percent, leading to the collapse of national stock markets, deepening trade deficits, and suspension of normal business activity.
- Political and social unrest surged to Indonesia, Malaysia, South Korea, Thailand, and the Philippines.

Participants in IB

- **Multinational enterprise (MNE):** A large company with substantial resources that performs various business activities through a network of subsidiaries and affiliates located in multiple countries.
- In addition to a home office, an MNE owns a worldwide network of subsidiaries.
- **Examples**- Caterpillar, Kodak, Nokia, Samsung, Unilever, Citibank, Vodafone, Carrefour, Bechtel, Four Seasons Hotels, Disney, DHL, & Nippon Life Insurance.
- **Examples** of *Fortune's* Global 500- Exxon Mobil, Royal Dutch Shell, BP, General Motors, DaimlerChrysler, Toyota, Ford, and Wal-Mart.

Geographic Location of Multinational Enterprises, 2006



Small and Medium-Sized Enterprise

A company with 500 or fewer employees in the United States, although this number may need to be adjusted downward for other countries.

- Small firms comprise 90 - 95 percent of all firms in most economies.
- Increasingly more SMEs participate in exporting, licensing, and global sourcing.
- Small firms are the drivers for innovation.
- Account for one-third of exports from Asia; a quarter of the exports from the affluent countries in Europe and North America
- Contribute more than 50 percent of total national exports in Italy, South Korea, and China.

Born Global Firm

Born global firm: a young entrepreneurial company that initiates international business activity very early in its evolution, moving rapidly into foreign markets.

SMEs:

- Are often more innovative, adaptable, and have quicker.
- Are better able to serve niche markets.
- Can better leverage the Internet.
- Due to limited resources, tend to minimize fixed costs and outsource.
- Tend to flourish on private knowledge that they cultivate through their knowledge networks and international social capital.

NGOs

Non-governmental Organizations (NGOs)

- They serve special causes, the arts, education, politics, religion and research.
- **Examples**:

  Bill and Melinda Gates Foundation

  CARE- dedicated to reducing poverty

  British Wellcome Trust- supports health and education

Why do Firms Internationalize?

1. Seek opportunities for growth through market diversification
2. Earn higher margins and profits
3. Gain new ideas about products, services, and business methods
4. Better serve key customers that have relocated abroad
5. Be closer to supply sources, benefit from global sourcing advantages, or gain flexibility in the sourcing of products

Why do Firms Internationalize?

6. Gain access to lower-cost or better-value factors of production
7. Develop economies of scale in sourcing, production, marketing, and R&D
8. Confront international competitors more effectively or thwart the growth of competition in the home market
9. Invest in a potentially rewarding relationship with a foreign partner

Why Study International Business?

- A facilitator of the global economy and interconnectedness
- A contributor to national economic well-being
- A competitive advantage for the firm
- An activity with societal implications
- A source of competitive advantage for you

Facilitator of Global Economy and Interconnectedness

- Since is the GATT (1947), following World War II, the world has transformed with unprecedented growth in IB.
- Firms increasingly focus on mass production efficiencies.
- **1980s-** political/economic transformations of *Emerging Markets* (about two-dozen countries) have given new impetus to worldwide economic interconnectedness.
- Fast-growth developing economies- Brazil, India, China, and Poland- have registered substantial market liberalization, privatization, and industrialization, fueling global economic transformation.
- Two drivers of the changing business landscape- globalization and technology
- The Internet and e-commerce make international business a viable and increasingly imperative option for firms of all sizes and resource levels.

Contributor to National Economic Well-Being

- International business promotes economic prosperity and living standards.
- International trade is a critical engine for job creation. **It is estimated that every $1 billion increase in exports creates more than 20,000 new jobs.**
- Cross-border trade directly supports at least 12 million U.S. jobs.
- One of every seven dollars of U.S. sales is made abroad.
- One of every three U.S. farm acres; and one of every six U.S. jobs is producing for export markets.
- **International business is both a cause and a result of increasing national prosperity.**
- Benefits of free exchange of products, services, capital, and technology.
- Prosperity is accompanied by literacy rate gains, nutrition and health care improvements, with some tendencies towards freedom and democracy.

A Competitive Advantage for the Firm

- **International Business = Superior Performance**
- **Maximize Returns**- Foreign markets often generate returns far superior to those in domestic markets.
- **Global Scale Economies**- International players can maximize their efficiencies by securing cost-effective factor inputs from around the world.
- **Examples**- Manufacturing facilities in emerging markets like Brazil, Mexico, and Poland; software development in India (Microsoft); auto assembly in Romania (Renault)
- **Resource Acquisition**- Access to otherwise unavailable critical resources
- **Enhanced Competitiveness/Knowledge Transfer**

An Activity with Societal Implications

- As trade barriers decline and global power increases, so does responsibility to society to be a good corporate citizen.
- This means having both economic and social goals; transcending legal standards by proactively implementing ethical standards.
- Large corporations like Wal-Mart, Unilever, and Sony have annual revenues larger than the GDPs of many of the nations they operate.
- The internationalization of thousands of firms negatively impacts the natural environment, e.g. pollution (Royal Dutch Shell's refining operations in Nigeria).
- Large banks and international investment brokers have disrupted the economies of nations with aggressive currency trading or by manipulating stock markets, e.g. MNEs abruptly withdrawing capital.
- Human Rights violations- Some MNEs ignore human rights and basic labor standards by establishing factories in countries that pay low wages with substandard working conditions, e.g. Nike in Asia.
- Building factories abroad often leads to job losses in the home country.

A Competitive Advantage for You

- Julie, the student in the opening vignette is touched everyday by a variety of global business transactions.
- She is considering a career in international business because she is grasping its importance and growing role in the world.
- Working across national cultures exposes managers to a diversity of experiences, new knowledge, novel ways of seeing the world, and unusual challenges.
- Internationally-experienced managers are typically more self-confident, cosmopolitan, and have positioned themselves for unique professional opportunities.

Global Competence is a Requirement for Contemporary Managers

- Open-mindedness
- Tolerance for ambiguity
- Perceptiveness
- Premium on personal relationships
- Flexibility, adaptability, and self-reliance
- Good sense of humor
- Warmth in human relationships
- A curious mind