CHAPTER 1

## An Overview of International Business

**Chapter Objectives**

After studying this chapter, students should be able to:

1. Discuss the meaning of international business.
2. Explain the importance of understanding international business.
3. Identify and describe the basic forms of international business activities.
4. Discuss the causes of globalization.
5. Comprehend the growing role of emerging markets in the global economy.

**LECTURE OUTLINE**

**OPENING CASE: *The Business of the Olympics***

The opening case explores the relationship between international business and the Olympic Games.

Key Points

1. The Olympic Games have come to reflect international business at its most intense.
2. The Olympics are governed by the International Olympic Committee (IOC), which decides where the games will be held, which sports will be represented, and oversees the selection of judges and referees.
3. Each country that wants to participate in the Olympics must establish its own committee, which then reports to the IOC.
4. Host cities are important to the Olympics because they are responsible for providing facilities, a volunteer workforce, and related organizational support.
5. Cities compete aggressively as they bid to be hosts. For cities, the Olympics mean a boost to tourism that continues long after the games are over, a chance to be in the international spotlight, and a catalyst for infrastructure improvements.
6. Running the Olympics requires large revenues, and host cities, along with the IOC, are constantly seeking additional sources of funds, such as television coverage and corporate sponsors.

*Additional Case Application*

An exercise that can help students make the connection between the Olympics and international business is to ask them to imagine the Olympics without the involvement of corporations. Students can be assigned to play the role of the different players involved in the games. For example, one student can play the role of an athlete, another the role of the mayor of the host city/cities, a third the head of the IOC, a fourth the head of the national committee, a fifth the role of a spectator, and so forth.

**CHAPTER SUMMARY**

Chapter One introduces the topic of international business by initially asking “what is international business” and then moving on to ask “why is it important to study international business?” The chapter then provides an introductory definition and explanation of some of the basic international business terminology, such as importing, exporting, and multinational corporation.

The chapter moves on to explore the evolution of international business going back to 2000 B.C. examining major developments that have resulted in the growth and maturation of international business as we know it today. The chapter concludes with an overview of the text.

**WHAT IS INTERNATIONAL BUSINESS?**

* **International business** involves any business transaction between parties from more than one country. It includes such activities as buying and selling raw materials, inputs or finished products across borders, operating plants in other countries to take advantage of local resources, and borrowing money in one country to finance operations in a second country.
* International business is different from domestic business in that it necessarily involves transactions that cross national borders while domestic business does not. Thus, at least one party will have to adjust to a different legal, economic, and cultural system; convert its currency into the other party’s currency; and make changes in how products are produced or the types of products that are produced.

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***Teaching Note*:**

Instructors may wish to pause for a moment at this point and ask students why a particular foreign company chose to invest in the United States. It is helpful to choose a company that is in the local area; however, some well-known examples that should also generate good discussion include Honda, Sony, and Nissan. While students probably won’t pick up on the finer points of why the investments were made, the question should at least get them to think about international business, and the question can be raised again later in the course.

**WHY STUDY INTERNATIONAL BUSINESS?**

***Teaching Note*:**

It is interesting to ask the question “why study international business” before actually discussing the material in the text. Instructors will probably find that, with a little prompting, students will eventually come up with all or most of the reasons listed below.

* Students need to study international business for a number of different reasons. First, students will almost certainly work for a company that is either foreign owned, domestically owned but has some foreign operations, or domestically owned but is affected by the global economy. Thus, if students are to be successful and productive in their careers, it is important that they understand at least the basics of why companies conduct business across borders. Secondly, since even small businesses are becoming more active in the international business environment through activities such as buying and supplying components, students who are planning to start their own businesses should also be cognizant of international business.
* Cultural literacy is another reason for studying international business. Because business today often means *international business*, it is critical that students develop the type of cultural literacy that will enable them to be conversant with the global economy and international marketplaces. Furthermore, students who fail to develop such skills will find themselves losing ground to their future “competitors” (students, particularly those from Europe and Japan, who have learned multiple languages, have had job experiences in other countries and traveled widely).
* Finally, since not all business techniques and tools are developed in the United States, students need to study international business so that they are aware of developments taking place in other parts of the globe, such as the use of **just-in-time (JIT)** systems.

**BRINGING THE WORLD INTO FOCUS**

This section points out that, despite previous expert predictions of a boundaryless world, boundaries and borders do matter. That reality impacts all aspects of international business, including, legal systems, political systems, social structures, cultural values, taxes, labor, land and other resources. The CAGE System developed by Pankaj Ghemawat provides a useful framework for understanding.

**INTERNATIONAL BUSINESS ACTIVITIES**

* International business can take various forms.  **Exporting** involves selling products made in one’s own country for use or resale in other countries. **Importing** involves buying products made in other countries for use or resale in one’s own country. Many companies begin their international operations with either importing or exporting since the risk involved is minimal.
* **Merchandise exports and imports** refers to trade in goods (also known as visible trade) while **service exports and imports** refers to trade in intangible products (also known as invisible trade). **See Figure 1.1 here.**
* Exporting is important to both large and small firms. For example, the text notes that 54 percent of Boeing Aircraft Company’s sales of $81.7 billion in commercial aircraft sales were to foreign customers, and that Task Force Tips, a small Indiana manufacturer of fire hose nozzles, exports one third of its production.

**BRINGING THE WORLD INTO FOCUS**

***The Early Era of International Business***

International business has been around for centuries. In fact, its origins can be traced back as far as 2000 B.C. to the trading that took place between North African tribes and parts of the Middle East. Greece and the Roman Empire owe part of their early prosperity to international trade and its associated political and military power. Some significant trading relationships that endure today were developed during the Middle Ages.

The colonization of America, brought about in part because important trading routes to the Middle East were cut off when the Turks conquered Constantinople, brought new trading avenues, particularly with Europe.

During the colonial period and the subsequent Age of Imperialism, foreign direct investment and multinational companies grew rapidly as Europeans invested in their colonial empires in America, Asia, and Africa. The invention of the steam engine, and its associated low cost transportation, further encouraged foreign investments in the nineteenth century.

* **International investments**, in which residents of one country supply capital to those of a second country, constitute the second major form of international business activity. **Foreign direct investments (FDI)** are investments made for the purpose of actively controlling property, assets, or companies located in foreign host countries. The country from which the investment flows is referred to as the **home country**. The country to which the investment flows is referred to as the **host country**. **Portfolio investments** involve purchases of foreign financial assets (stocks, bonds, certificates of deposit) for purposes other than control.
* **Other forms of international business activity**. A **licensing** agreement allows a firm in one country to use all or some of the intellectual property of a firm in a second country in exchange for a royalty payment. A **franchising** agreement allows a firm in one country to use the brand names, logos, and operating techniques of a firm in a second country in exchange for a royalty payment. **Management contracts** involve an agreement in which a firm in one country agrees to operate facilities or provide other management services for an agreed-upon fee.

There are several ways to describe the extent of a firm’s international orientation. At the broadest level is the international business: an organization that engages in commercial transactions with individuals, private firms, or public sector organizations that cross borders. The term multinational corporation (MNC) is used to identify firms with extensive involvement in international business. More precisely, an MNC is a firm that “engages in foreign direct investment and owns or controls value-adding activities in more than one country.” MNCs also typically buy resources, create goods and/or services, and then sell those goods and services in a variety of countries. Control and coordination usually come from headquarters with subsidiaries making adjustments as necessary. Non-corporations may sometimes be known as multinational enterprises (MNEs), while not-for-profits are sometimes known as multinational organizations (MNOs). See Table 1.1 here.

##### THE ERA OF GLOBALIZATION

Globalization can be defined as “the inexorable integration of markets, nation-states, and technologies…in a way that is enabling individuals, corporations, and nation-states to reach around the world farther, faster, deeper, and cheaper than ever before.” This is evidenced by the dramatic growth of international trade over the last several decades. You may also note the impact of the Global recession. In 2009, trade volumes decreased more than the world’s GDP did, thus causing the ratio of trade to GDP to fall. The growth in foreign direct investment (FDI) has also been tremendous (by 2011, the stock of FDI equaled almost 26 percent of that years GDP).

##### CONTEMPORARY CAUSES OF GLOBALIZATION

Today, firms expand internationally for a variety of reasons. Some of the reasons are strategic, others are environmental.

**Strategic Imperatives**

* *To leverage core competencies*. That is, firms that have skills that help them compete successfully in one country will often expand in order to further benefit from those skills.
* *To acquire resources and supplies*. The price and availability of materials, land, labor, capital, and technology varies across countries. Firms may be able to acquire resources or produce more efficiently by expanding internationally.
* *To seek new markets*. Once a company's home market becomes saturated, sales can be increased by expanding to markets beyond the firm's home country's borders.
* *To better compete with rivals*. Firms often prefer to not concede markets to a rival. Therefore, when one firm expands into a new market, other firms in the same industry may follow.

**The Environmental Causes of Globalization**

* *Changes in the political environment*. The collapse of trade barriers (especially since WWII) and the establishment of new trade agreements (e.g., NAFTA, CAFTA-DR, GATT/WTO) have promoted greater international trade and investment.
* *Technological changes*. Phones, faxes, e-mail, air travel, and a host of other technological changes have made international business easier and more feasible than ever before.

**Globalization and Emerging Markets**

* International business activity has expanded geographically with the collapse of European communism and policy changes in China and India. The markets beyond North America, Western Europe, and Japan are often referred to as **emerging markets**. Some scholars limit emerging markets to Brazil, Russia, India, and China (**BRIC countries**). Others use different categorizations. **Table 1.2**, which provides demographic information on emerging markets, should be discussed here.

**EMERGING OPPORTUNITIES**

***Is Globalization Good for Us?***

This box considers the conflicting aspects of globalization as described by Thomas L. Friedman in his book *The Lexus and the Olive Tree*. The economic integration associated with globalization may lead to many economic benefits (i.e., the Lexus), but it may also create costs as traditional values and norms (the olive tree) are forsaken.

###### AN OVERVIEW OF THE BOOK

* The text takes the perspective of the manager or employee who is or will be competing in the international marketplace and identifies the major similarities and differences between doing business domestically and doing business internationally.
* The text develops the more macro, general issues before moving on to explore the more micro, specific areas that managers face on a regular basis. In doing so, students will become familiar with the context within which international business takes place before examining the international manager’s tasks.
* Part One provides an overview of the world's marketplaces. Parts Two through Four move from broader issues, such as the international environment, to the international firm, and finally to discussing specific functions within international firms.

CHAPTER REVIEW

*1-1 What is international business? How does it differ from domestic business?*

International business involves any business transaction between parties from more than one country. It differs from domestic business in that international business transactions cross national borders while domestic transactions do not. More specifically, international business involves foreign currency transactions for at least one party, it may require a company to adjust to a foreign legal system and/or culture, and the way products are produced or the types of products that are produced may vary according to the availability of resources in different countries. (LO 1.1, AACSB: Communication Skills, Learning Outcomes: Define the fundamental concepts of international business)

*1-2 Why is it important for you to study international business?*

There are at least five reasons why it is important to study international business. First, students will probably work for a company with international operations or one that is affected by the global economy. Second, students may actually work for a firm that is owned by a corporation based in another country. Third, it is important to keep pace with future “competitors” (other job seekers) who are well versed in international business. Fourth, it is important to stay abreast of the latest business techniques and tools, which may actually be developed outside of the United States. Finally, it is important to avoid cultural illiteracy, a label given to those who are not conversant with the global economy and international marketplaces. (LO 1.2, AACSB: Communication Skills, Learning Outcomes: Define the fundamental concepts of international business)

*1-3 What are the basic forms of international business activity?*

The basic forms of international business activity are importing and exporting, international investments, licensing, franchising, and management contracts. Exporting involves selling products made in one’s own country for use or resale in other countries, while importing involves buying products made in other countries for use or resale in one’s own country. International investments include foreign direct investment and portfolio investments. Foreign direct investments are investments made for the purpose of actively controlling property, assets, or companies located in foreign host countries, while portfolio investment involves the purchase of foreign financial assets, such as stocks, bonds, and certificates of deposit for purposes other than control. A licensing agreement allows a firm in one country to use all or some of the intellectual property of a firm in another country in exchange for a royalty payment. A franchise agreement authorizes a firm in one country to utilize the brand names, logos, and operating techniques of a firm in a second country in exchange for a royalty payment. Management contracts involve an agreement in which a firm in one country operates facilities or provides other management services to a firm in another country for a fee. (LO 1.3, AACSB: Communication Skills, Learning Outcomes: Define the fundamental concepts of international business)

*1-4 How do merchandise exports and imports and service exports and imports differ?*

Merchandise exports and imports refer to trade in goods while service exports and imports refer to trade in intangible products. The former is sometimes referred to as visible trade while the latter is sometimes referred to as invisible trade. (LO 1.3, AACSB: Communication Skills, Learning Outcomes: Define the fundamental concepts of international business)

*1-5 What is portfolio investment?*

Portfolio investments involve purchasing foreign financial assets such as stocks, bonds, and certificates of deposit for purposes other than control. (LO 1.3, AACSB: Communication Skills, Learning Outcomes: Define the fundamental concepts of international business)

*1-6 What are the basic reasons for the recent growth of international business activity?*

A number of factors have led to the recent growth of international business. The more important factors include market expansion, resource acquisition, competitive forces, technological change, and social change. Market expansion has led to growth in international business as firms, facing saturated domestic markets, seek new market opportunities in other countries. In some cases, firms will also expand into other markets as they seek resources such as materials, labor, and/or capital. Such resources may either be scarce or unavailable domestically. The competitive forces that exist in today’s marketplace also encourage the internationalization of business. When a firm’s competitors expand into new markets, that firm must also internationalize. Changes in technology, particularly in areas such as communications, transportation, and information processing, are making it increasingly easier for firms to carry out international transactions, thus adding to the growth of international business. Social change is making it possible for firms to sell their products more easily in foreign markets. Consumers today are much more aware of the products and services being offered in other markets, and are therefore more likely to seek out foreign-made products than in the past. Finally, looser government trade and investment policies have made it easier for international businesses to capitalize on growth opportunities in the global marketplace. (LO 1.4, AACSB: Communication Skills, Learning Outcomes: Discuss trends in and the debate over globalization)

QUESTIONS FOR DISCUSSION

*1-7 Why do some industries become global while others remain local or regional?*

There are a number of factors that play a role in determining which industries become global, which become regional, and which remain local. The airline industry, for example, is considered a global industry. One of the main reasons for this status is the cost of developing and producing large aircraft, combined with market size. The industry is “forced” to be global because it must sell aircraft to a marketplace that is big enough to justify the costs of developing and building new jets. No single country has a market big enough to justify such costs, thus companies must seek customers around the globe. On the other hand, the bakery industry tends to be regional or local because its products tend to perish very easily. While improvements in transportation and shipping have created a larger marketplace, for the most part, firms in this industry cater to local customers. From this brief discussion, it is clear that factors such as cost, market size, and product life all play a role in determining which industries will be global and which will not. However, it is important to recognize that many other factors (for example, resource availability, government regulations, and similarity of customer taste) also play a role in this determination. (LO 1.4, AACSB: Analytical Skills, Learning Outcomes: Discuss trends in and the debate over globalization)

*1-8 What is the impact of the Internet on international business? Which companies and which countries will gain as Internet usage increases throughout the world? Which will lose?*

The Internet has had a significant impact on international business in at least three ways. First, the Internet facilitates international trade in services (e.g., banking, education, and retailing). Second, it has helped level the playing field between large and small firms entering a foreign market, since even small firms can sell their products internationally on the Web. Third, the Internet can make business-to-business transactions (e.g., bringing together suppliers and buyers) much easier and more efficiently. (LO 1.4, AACSB: Analytical Skills, Learning Outcomes: Discuss trends in and the debate over globalization)

*1-9 Which markets are more important to international business – the traditional markets of North America, the European Union, and Japan or the emerging markets? Defend your answer.*

Clearly, the volume of business in the traditional markets is much greater than the volume in emerging markets. However, as the traditional markets become saturated, opportunities for growth will increasingly shift toward emerging markets. (LO 1.4, AACSB: Analytical Skills, Learning Outcomes: Discuss trends in and the debate over globalization)

*1-10 Does your college or university have any international programs? Does this make the institution an international organization? Why or why not?*

Students who attend a college or university that has international programs will probably find this question interesting. Students who do not have international programs available to them can still find the question worth considering if they use a little imagination. The text defines international organizations to include public sector organizations that cross national borders. With this definition in mind, a college or university could very well be considered an international organization. However, it is important to consider the type of international programs an institution has to offer. For example, one could argue that a university that simply offers several courses that deal with international business is not an international organization because the institution at that point does not cross borders (see definition above). In contrast, it could be argued that a university that offers courses in international business and also offers a student exchange program is an international organization because the missing element in the previous example (of crossing borders) is fulfilled because of the exchange program. The key point in this question, therefore, is to determine exactly when international programs make a college or university an international organization. (LO 1.2, AACSB: Analytical Skills, Learning Outcomes: Discuss trends in and the debate over globalization)

*1-11 What are some of the differences in skills that may exist between managers in a domestic firm and those in an international firm?*

When compared to domestic managers, international managers, by definition, are more likely to consider business from a global perspective. In doing so, international managers should consider such variables as exchange rates, cultural differences, differences in the political and economic environments, trade barriers, and so forth. In contrast, the domestic manager is not likely to be concerned with any of these variables and will instead focus on the domestic marketplace. The international manager will probably see the world as the marketplace and in doing so, develop a keen awareness of the differences between markets, while the domestic manager will not. (LO 1.2, AACSB: Analytical Skills, Learning Outcomes: Discuss trends in and the debate over globalization)

*1-12 Would you want to work for a foreign-owned firm? Why or why not?*

The answer to this question is, of course, based on a student’s opinion and therefore can generate a lot of discussion. Some students may already work for a foreign-owned firm; some may work for a foreign-owned firm and not realize it. Students who work for foreign-owned companies can be asked to contrast their experiences in the company with positions they may have held elsewhere (or can be asked to simply comment on their experiences if they have not held other positions). This can set the stage for a discussion of the merits of working for or not working for foreign-owned companies. (LO 1.2, AACSB: Analytical Skills, Learning Outcomes: Discuss trends in and the debate over globalization)

BUILDING GLOBAL SKILLS

*Essence of the exercise*

This exercise is designed to help students realize just how extensive the effect of international business is by asking them to consider the country of origin of items that are part of their daily lives, such as their cars, clocks, coffee makers, and computers. The exercise requires students to compile a list of products they use on a regular basis and find out more about the companies that produce them.

*Answers to the follow-up questions:*

*1-13* *In which country is the firm headquartered?*

Student answers may vary.

*1-14* *What percentage of the firm’s sales come from its home market? What percentage comes from other countries?*

 Student answers may vary.

*1-15* *Where was the item most likely manufactured?*

Student answers may vary.

*1-16* *Why do you think it was manufactured there?*

 Student answers may vary, but will probably include cost or location factors, or access to resources and/or materials.

*1-17 Discuss the relative impact of international business on your daily lives.*

If this exercise is used at the beginning of class, prior to coverage of the chapter material, many students will probably be at a loss as to how international business affects their daily lives. If the exercise is used after the chapter material has been covered, students will probably be able to discuss things such as the fact that their cars may be made by a foreign company or that they work for a company that is foreign-owned. (LO 1.2, AACSB: Communication Skills, Learning Outcomes: Discuss trends in and the debate over globalization)

*1-18 Compile a combined list of the 10 most common products the average college student might use.*

The lists that students compile will vary; however, some of the more common items that might appear are pens, computers, cars, and beer. (LO 1.4, AACSB: Analytical Skills, Learning Outcomes: Discuss trends in and the debate over globalization)

*1-19 Try to identify the brands of each product that are made by domestic firms.*

Students will probably identify different brands; some of the more common ones that are related to the products listed in Question 2 above are: Paper-mate, IBM, Ford, and Budweiser. (LO 1.4, AACSB: Analytical Skills, Learning Outcomes: Discuss trends in and the debate over globalization)

*1-20 Try to identify brands of each item that are made by foreign firms.*

Students will probably have more difficulty with this question. Again, using the products listed in Question 2 above, foreign brand names might include: Bic, Goldstar, Honda, and Bass. (LO 1.4, AACSB: Analytical Skills, Learning Outcomes: Discuss trends in and the debate over globalization)

*1-21 Does your list of 10 products include items that have components that are both domestic- made and foreign-made?*

The answer to this question will probably require a bit of guesswork. However, of the products listed in Question 2, one could argue that the car and possibly the computer are probably assembled with both U.S.- and non-U.S.-made components. (LO 1.4, AACSB: Analytical Skills, Learning Outcomes: Discuss trends in and the debate over globalization)

*Other Applications*

Instructors can develop a “quiz” to be handed out on the first day of class, perhaps even before discussing the chapter material. The quiz should be in multiple-choice format and should ask students to identify the country of origin of various companies and/or products. Instructors will probably find that students are amazed to find out that products they think are American-made are not and that products they think are German-made are actually Japanese-made, etc. Instructors should provide the correct answers right after students have taken the quiz, using a discussion format. This method will not only help students realize the extent of international business, but it will also help them realize that they and their classmates have a lot to learn.

This type of quiz requires a bit of legwork on the part of the instructor in that companies and/or products must be researched in order to develop the quiz, but it is well worth the effort. (LO 1.4, AACSB: Analytical Skills, Learning Outcomes: Discuss trends in and the debate over globalization)

CLOSING CASE

***Demography Is Destiny***

The closing case describes the challenges facing countries as their population ages and eventually shrinks.

Key Points:

1. Changes in national demographics have led to changes in labor policies in various countries, such as France, the U.S., England, and China.
2. The traditional population pyramid (broad base of youngsters, shrinking in size as age increases) is becoming a population oval or rectangle as disease and famine are tamed.
3. The populations of many major economic powers are predicted to become older and smaller over the next two decades.
4. This will lead to fewer young workers to support each elderly retiree – also referred to as a rising old-age dependency ratio.
5. As the supply of labor is reduced, labor costs will likely go up. Taxes will also go up as the expenses associated with caring for the aged increase.
6. Consumption patterns will also change, as an aging population consumes more medical-related products and fewer new homes, automobiles, etc.

**Case Questions**

*1-22 What challenges do graying populations create for companies?*

The challenges are primarily in maintaining their workforce and forecasting changes in consumption patterns. Companies like Toyota are already designing their work areas to make them comfortable for an aging workforce. Companies also need to tailor and effectively market products to aging consumers. (LO 1.5, AASCB: Dynamics of the Global Economy, Learning Outcomes: Discuss trends in and the debate over globalization)

*1-23 What opportunities do graying populations create for firms?*

There will be increasing demand for a host of new products. The case illustrates this in terms of medicine, eye care, cookware, financial services, and so on. (LO 1.5, AASCB: Dynamics of the Global Economy, Learning Outcomes: Discuss trends in and the debate over globalization)

*1-24 How will demographic changes affect the competitiveness of countries in the international marketplace?*

The burden of caring for the elderly will be borne disproportionately by countries with low or negative population growth rates. These countries will have a smaller labor pool and higher age-dependency ratios. Countries with higher population growth rates (such as India) will have lower wage rates (because of an abundance of labor) and the expense of caring for the elderly will be spread across a larger group of young workers. (LO 1.5, AASCB: Dynamics of the Global Economy, Learning Outcomes: Discuss trends in and the debate over globalization)

*1-25* *What can countries do to counteract the impact of these demographic changes on their economic competitiveness?*

Nations will have to find ways to support older citizens and prepare for the impact of an aging population upon the public treasury. This may impact tax policies and governmental spending. Nations will also have to address labor concerns as an increasing portion of the labor supply will be employed caring for retirees, thereby decreasing the availability of labor in other sectors. (LO 1.5, AASCB: Dynamics of the Global Economy, Learning Outcomes: Discuss trends in and the debate over globalization)

 *1-26* *What has been the impact of the one-child policy on China’s economic fortunes?*

Perhaps the policy worked too well. China’s working age population is expected to start shrinking in 2015. The one-child policy means that as parents retire from the workforce, there will only be one young worker to support them. As life expectancy increases, there may only be one young worker to support the two parents and four grandparents as well. Further, the one-child policy has led to an imbalance in the number of males and females (more male than female children being born), which

will affect the marriage market, family formation, and eldercare in China. (LO 1.5, AASCB: Dynamics of the Global Economy, Learning Outcomes: Discuss trends in and the debate over globalization)

*1-27. Go to the U.S. Census Bureau’s international data base at www.census.gov. Pick two countries and analyze their changing demographics. Which one faces the more favorable demographic future?*

Student answers may vary.