Chapter 11: International Business

Exercises — Exercises

Q1 Differentiate between international trade and international business.

International trade means the export and import of goods (and services) between countries. International business is a much broader term. It covers trade in goods and services and also other cross-border activities: movement of capital, personnel, technology and intellectual property such as patents, trademarks, know-how and copyrights. It includes licensing and franchising, foreign investment (direct and portfolio), contract manufacturing, joint ventures and overseas production of goods and services. So all international trade is part of international business, but international business is more than international trade.

Q2 Discuss any three advantages of international business.

Three advantages to firms: (1) Prospects for higher profits: when domestic prices are low, a firm can earn more by selling in countries where prices are high. (2) Increased capacity utilisation: a firm with production capacity above domestic demand can use the surplus by taking foreign orders. Larger-scale production also brings economies of scale, which lower cost and raise the profit margin per unit. (3) Prospects for growth: when domestic demand is saturated, entering overseas markets lets a firm keep growing. Multinationals from developed countries entered developing countries for this reason.

Q3 What is the major reason underlying trade between nations?

The major reason is that countries cannot produce equally well or equally cheaply everything they need. Natural resources are unequally distributed, and factors of production such as labour, capital and raw materials differ across nations. Labour productivity and production costs also differ because of socio-economic, geographical and political factors. So a country can produce some goods better or at lower cost than others can. Each country therefore produces what it does most efficiently and buys the rest from other countries that produce those goods at lower cost. This geographical specialisation gives rise to international business.

Q4 Differentiate between contract manufacturing and setting up wholly owned production subsidiary abroad.

Contract manufacturing: a firm contracts one or a few local manufacturers in a foreign country to produce components or goods to its specifications. It needs little or no investment abroad, so investment risk is low, and production may be cheaper where material and labour costs are low. The firm has less control, since quality standards may not be followed. A wholly owned subsidiary: the parent makes 100 per cent equity investment, either by setting up a new (green field) firm or by acquiring an established one. It has full control and need not disclose technology or trade secrets. But it needs heavy funds, so it is unsuitable for small firms. The parent alone bears all losses, and political risk is higher.

Q5 Why is it necessary for an export firm to go in for pre-shipment inspection?

The Government of India wants only good quality products to be exported. For this it passed the Export (Quality Control and Inspection) Act, 1963, and made inspection of certain products compulsory by a competent agency designated by the government, such as the Export Inspection Agency. If the product falls in such a category, the exporter must get an inspection certificate. The pre-shipment inspection report has to be submitted with the other export documents. Some importing countries also make the certificate of inspection mandatory. Inspection is not compulsory for goods exported by star trading houses, trading houses, export houses, units in EPZs/SEZs and 100 per cent export oriented units.

Q6 What is bill of lading? How does it differ from bill of entry?

A bill of lading is a document in which a shipping company officially acknowledges receipt of the goods put on board its vessel and promises to carry them to the port of destination. It is also a document of title to the goods and is freely transferable by endorsement and delivery. It is issued after the shipping company receives the mate's receipt and the freight. A bill of entry is a form supplied by the customs office to the importer. The importer fills it in, in triplicate, at the time of receiving the goods, and submits it to the customs office. It gives importer and exporter details, the ship, packages, goods, quantity, value and the customs duty payable. In short, the bill of lading is a shipping document for export, while the bill of entry is a customs document for import duty.

Q7 What is a letter of credit? Why does an exporter need this document?

A letter of credit is a guarantee issued by the importer's bank that it will honour payment, up to a certain amount, of the export bills presented by the exporter's bank. It is the most appropriate and secure method of payment for settling international transactions. The exporter needs it to assess and reduce the risk of non-payment by the importer once the goods reach the destination. Having a letter of credit, along with a confirmed order, also lets the exporter go to the bank for pre-shipment finance to produce the goods.

Q8 Discuss the process involved in securing payment for exports.

After shipment, the exporter informs the importer. The importer needs documents to claim title to the goods and clear them through customs: certified invoice, bill of lading, packing list, insurance policy, certificate of origin and letter of credit. The exporter sends these through his banker with a bill of exchange, to be delivered to the importer on acceptance of the bill. Submitting the documents to the bank to get payment is called negotiation of documents. A sight draft (documents against payment) hands over the documents only against payment. A usance draft hands them over against acceptance of the bill, for payment after a period such as three months. The exporter's bank receives the payment through the importer's bank and credits the exporter. To get money immediately, the exporter can sign a letter of indemnity, undertaking to repay the bank with interest if the importer does not pay. Finally the exporter obtains a bank certificate of payment.

Q9 "International business is more than international trade". Comment.

The statement is correct. Many people treat international business as international trade, which means exports and imports of goods and has historically been an important part of it. But its scope has expanded greatly. International business includes: (1) merchandise exports and imports; (2) service exports and imports, such as tourism, transportation, banking, insurance, communication and consultancy, known as invisible trade; (3) licensing and franchising, where a foreign party produces or sells under your trademarks, patents or copyrights for a fee; (4) foreign investment, both direct (FDI) and portfolio; and also contract manufacturing and joint ventures. It also involves movement of capital, personnel, technology and intellectual property, and firms produce abroad to serve customers better at lower costs. So international business covers both trade and production of goods and services across frontiers, which is wider than trade alone.

Q10 What benefits do firms derive by entering into international business?

Firms gain the following benefits. (i) Prospects for higher profits: they can sell in countries where prices are higher than at home. (ii) Increased capacity utilisation: surplus capacity can be used for foreign orders, and larger-scale production brings economies of scale, lower costs and a better profit margin per unit. (iii) Prospects for growth: when domestic demand is saturated, overseas markets allow growth, as multinationals from developed countries found in developing countries. (iv) A way out of intense domestic competition: internationalisation can be the only route to significant growth, so international business acts as a catalyst of growth for firms in tough domestic markets. (v) Improved business vision: going international comes from the urge to grow, become more competitive, diversify and gain strategic advantages, and so forms part of a firm's strategic management.

Q11 In what ways is exporting a better way of entering international markets than setting up wholly owned subsidiaries abroad.

Exporting is better in these ways. (1) It is the easiest way of entering international markets, far less complex than setting up and managing joint ventures or wholly owned subsidiaries abroad. (2) It needs much less time and money, whereas a wholly owned subsidiary demands 100 per cent equity investment, which small and medium firms often cannot afford. (3) It needs little investment in foreign countries, so exposure to foreign investment risk is nil or much lower. With a subsidiary the parent alone bears all losses if the foreign operation fails. (4) It avoids the political risk faced by subsidiaries, since some countries dislike 100 per cent foreign-owned units. (5) Firms usually start with exports and imports and later move to other modes once they know the foreign market. Exporting has drawbacks, such as transport costs, customs duties and import restrictions, but the source shows it is the preferred initial route.

Q12 Rekha Garments has received an order to export 2000 men's trousers to Swift Imports Ltd., located in Australia. Discuss the procedure that Rekha Garments would need to go through for executing the export order.

Rekha Garments would follow the export procedure. (1) Receive Swift Imports' enquiry and send a quotation (proforma invoice) giving price, quality, size, packing and payment terms. (2) Receive the order (indent). (3) Check Swift's creditworthiness and ask for a letter of credit. (4) Obtain an export licence: bank account with an RBI-authorised bank, IEC number from DGFT, registration with the Apparel Export Promotion Council (RCMC) and with ECGC. (5) Obtain pre-shipment finance from the bank. (6) Produce or procure the trousers. (7) Get pre-shipment inspection, if required. (8) Seek excise clearance or duty drawback. (9) Obtain a certificate of origin. (10) Reserve shipping space and get a shipping order. (11) Pack, mark and forward the goods. (12) Insure them. (13) Get customs clearance by submitting the shipping bill with the required documents, via a C&F agent. (14) Obtain the mate's receipt. (15) Pay freight and get the bill of lading. (16) Prepare the invoice. (17) Send documents through the bank with a bill of exchange, and secure payment.

Q13 Your firm is planning to import textile machinery from Canada. Describe the procedure involved in importing.

Import procedure: (i) Trade enquiry: collect information on Canadian exporters from trade directories and associations, and send a trade enquiry; the exporter replies with a quotation (proforma invoice). (ii) Procure an import licence if the machinery is subject to licensing (check the EXIM policy), after registering with DGFT for an IEC number. (iii) Obtain foreign exchange sanction through an RBI-authorised bank. (iv) Place the import order (indent) with clear terms. (v) Obtain a letter of credit from the bank and send it to the supplier. (vi) Arrange finance in advance to avoid demurrage. (vii) Receive the shipment advice. (viii) Retire import documents by paying (sight draft) or accepting (usance draft) the bill of exchange. (ix) On arrival, the import general manifest is provided and cargo is unloaded. (x) Customs clearance: get the delivery order, pay dock dues for the port trust dues receipt, file the bill of entry, pay import duty, have the goods examined, and receive the release order, ideally through a C&F agent.

Q14 What is IMF? Discuss its various objectives and functions.

The International Monetary Fund (IMF) is an international financial institution established in 1945 and headquartered in Washington DC, set up to build an orderly system of international payments and exchange rates. India turned to it in 1991 when it faced a balance of payment crisis. Objectives: (1) promote international monetary cooperation among member countries; (2) encourage balanced growth of international trade, which supports employment and income; (3) maintain exchange rate stability and orderly exchange arrangements, avoiding competitive currency depreciation; (4) make international payments among members easier by removing exchange restrictions. Functions: (1) it gives short-term financial assistance to members facing balance of payment deficits, usually with policy conditions attached; (2) it oversees members' exchange rate policies and the par value of currencies, permitting adjustments when needed to keep the system orderly; (3) it acts as a lender and reserve pool of foreign currency from which members can borrow; (4) it monitors members' economies and offers technical advice and training.

Q15 Write a detailed note on features, structure, objectives and functioning of WTO.

The World Trade Organisation (WTO) was established in 1995 as the successor to the General Agreement on Tariffs and Trade (GATT), with headquarters in Geneva. It looks after trade in goods and services and trade-related intellectual property rights. Features: it is a permanent rule-making body; it covers goods, services and intellectual property; decisions are taken by consensus of member nations; and members must extend non-discriminatory (most-favoured-nation) treatment to each other. Structure: the Ministerial Conference of all members is the highest authority and meets at least once every two years; the General Council manages day-to-day work and also sits as the Dispute Settlement Body and Trade Policy Review Body; specialised councils and committees handle goods, services and intellectual property; a Secretariat headed by the Director-General provides administrative support. Objectives: reduce tariff and non-tariff barriers; use world resources optimally for sustainable development; raise living standards of member countries. Functioning: it administers trade agreements, provides a forum for negotiating trade rules, settles disputes between members, reviews national trade policies, and sets a common code of conduct to curb trade discrimination.