# CHAPTER - 11
# INTERNATIONAL BUSINESS - I

## I.Multiple Choice Questions

Question 1. In which of the following modes of entry, does the domestic manufacturer give the right to use intellectual property such as patent and trademark to a manufacturer in a foreign country for a fee
(a) Licensing (b) Contract manufacturing
(c) Joint venture (d) None of these
Question 2. Outsourcing a part of or entire production and concentrating on marketing operations in international business is known as
(a) Licensing (b) Franchising
(c) Contract manufacturing (d) Joint venture
Question 3. When two or more firms come together to create a new business entity that is legally separate and distinct from its parents it is known as
(a) Contract manufacturing (b) Franchising
(c) Joint ventures (d) Licensing
Question 4. Which of the following is not an advantage of exporting?
(a) Easier way to enter into international markets
(b) Comparatively lower risks
(c) Limited presence in foreign markets
(d) Less investment requirements
Question 5. Which one of the following modes of entry requires higher level of risks?
(a) Licensing (b) Franchising
(c) Contract manufacturing (d) Joint venture
Question 6. Which one of the following modes of entry permits greater degree of control over overseas operations?
(a) Licensing/franchising (b) Wholly owned subsidiary

**(c) Contract manufacturing (d) Joint venture**
**Question 7. Which one of the following modes of entry brings the firm closer to international markets?**
**(a) Licensing (b) Franchising**
**(c) Contract manufacturing (d) Joint venture**
**Question 8. Which one of the following is not amongst India’s major export items?**
**(a) Textiles and garments (b) Gems and jewellery**
**(c) Oil and petroleum products (d) Basmati rice**
**Question 9. Which one of the following is not amongst India’s major import items?**
**(a) Ayurvedic medicines (b) Oil and petroleum products**
**(c) Pearls and precious stones (d) Machinery**
**Question 10. Which one of the following is not amongst India’s major trading partners?**
**(a) USA (b) UK**
**(c) Germany (d) New Zealand**
**Answer:**
1. (a) 2. (c) 3. (c) 4. (a) 5. (c)
6. (b) 7. (c) 8. (d) 9. (6) 10. (d)

## II. Short Answer Type Questions

**Question 1. Differentiate between international trade and international business.**
**Answer:** Difference between international trade and international business is similar to difference between trade and business.

1. The scope of international business is much wider than international trade. International trade means exports and imports of goods which is an important component of international business but international business includes much more than this.
2. International trade in services like travel and tourism, transportation, communication, banking, warehousing, distribution and advertising is a part of international business.
3. International business also includes foreign direct investments, contract manufacturing, and setting up wholly owned subsidiaries etc. which are not included in international trade.

**Question 2. Discuss any three advantages of international business.**
**Answer:** The following are some of the advantages of foreign trade:

1. **Optimum use of resources:** Foreign trade helps in the optimum use of natural resources and avoids wastage’s of resources. It ensures the presence of stable price by avoiding wide fluctuations in prices. It tries to equalise the world price.
2. **Increased standard of living:** It ensures more production to meet the demand of the people of different countries. By increased production, it becomes possible to increase income and the standard of living of its people. It also increases the standard of living by increasing more employment opportunities. It enables a country to import those goods which it cannot produce.
3. **Large scale production:** It ensures large production because the production is carried on to meet the demand of its people as well as world market. Large scale production also ensures a great deal of internal economies which reduces the cost of production.

**Question.3. What is the major reason under lying trade between nations?**
**Answer.** The major reason behind international business is that the countries cannot produce equally well or cheaply all the commodities. This is called theory of comparative cost advantage. It is so because resources are unequally distributed in natural resources. Some countries are abundant in one commodity and scarce in others while opposite is true for some

other country. It makes a case for international trade and exchanging abundant commodity with scarce commodity by nations. Different nations are endowed with different factors of production which includes land, labour, capital and entrepreneurship. For example, India is a labour abundant country. Therefore, it is advisable for India to produce such commodities which use labour intensive methods and exchange it for those which use capital intensive methods. USA is a capital abundant country. Therefore, nations need to trade. Due to these reasons one country has a comparative advantage in production of particular goods as compared to other countries. Consequently, each country fins it advantageous to produce those selected goods and services that it can produce more effectively at home and importing those goods in which other nations have a comparative cost advantage.

**Question 4. Discuss as to why nations trade.**
**Answer:** Nations trade because of following reasons:

1. **Unequal distribution of natural resources:** Resources are unequally distributed in natural resources. Some countries are abundant in one commodity and scarce in other while opposite is true for some other country. It makes a case for international trade and exchanging abundant commodity with scarce commodity by nations.
2. **Unequal availability of factors of production:** Different nations are endowed with different factors of production which includes land, labour, capital and entrepreneurship. For example, India is a labour abundant country. Therefore, it is advisable for India to produce such commodities which use labour intensive methods and exchange it for those which use capital intensive methods. USA is a capital abundant country. Therefore, nations need to trade.
3. **Theory of Comparative Cost Advantage:** Due to these factors, some countries are in an advantageous position in producing selected goods and services which other countries cannot produce that effectively and efficiently and vice-versa. Consequently, each country finds it advantageous to produce those selected goods and services that it can produce more effectively at home and importing those goods in which other nations have a comparative cost advantage.
4. **Geographical Specialisation:** The international business as it exists today is the result of geographical specialisation. Even within a country each state specialises in those goods for which it is geographically more suitable. Similarly, each nation specialises in those goods in which it is specialised as per availability of resources and exchanges it for other goods and services in foreign market.
5. **Cost minimization principle of firms:** Firms get involved in international business to minimise their costs and maximise their profits.

**Question 5. Enumerate limitations of contract manufacturing.**
**Answer:** Major limitations of contract manufacturing are discussed below:

1. **Non adherence to quality standards:** Local firms may not adhere to quality standards or product design. It may cause serious quality problems for international firm. .
2. **No control on production by local producer:** Local producer has no control on manufacturing as goods are manufactured strictly as per the terms and specifications by international firm.
3. **Zero control over sales:** Local producer can't sell the output to customers directly. He needs to sell to the international firm at a pre-determined price. It reduces profits of local firm.

**Question 6. Why is it said that licensing is an easier way to expand globally?**

**Answer:** It is said that licensing is an easier way to expand globally because of its advantages over other modes of international business.

1. **Less Expensive:** Under the licensing, it is the licensee who sets up the business unit. Therefore, licensor has to invest no money. Therefore, it is considered as a cheaper way of entering*into international business.
2. **Zero Risk of Loss:** Licensor need not take pain of risk of profits and loss. He is paid a pre-determined fees called royalty by the licensee. As long as licensor continues to produce under the license, licensor keeps on getting his fees irrespective of whether licensee is making profits or incurring losses.
3. **Less risk of government intervention or takeovers:** A local person handles the business in foreign country. Therefore, there are lesser chances of government intervention or takeovers.
4. **Better knowledge of local needs:** Since licensee is the local person, he has better understanding of local needs, marketing strategies and business environment.
5. **Safety of Intellectual Property Rights:** As per the terms of the licensing, only licensee can make use of licensor's copyrights, patents and brand names in foreign countries. Therefore, there is lesser risk of these intellectual property rights being missed by other local firms.

**Question 7. Differentiate between contract manufacturing and setting up wholly owned production subsidiary abroad.**

**Answer:** The difference between contract manufacturing and wholly owned subsidiary is discussed below:

| Basis | Contract Manufacturing | Wholly Owned Subsidiary |
|---|---|---|
| Meaning | It refers to the type of international business where a firm enters into contract with some local manufactures in foreign countries to get certain components of goods produced as per their specifications. | In this the parent company acquires the full control over the foreign company by purchasing its 100% equity capital. |
| Forms | It can take three forms:<br>(*a*) Getting produced certain parts of final products which will be used for the production of final products later.<br>(*b*) Assembly of components into final products.<br>(*c*) Complete manufacture of the products like garments. | It can be established in two ways:<br>(*a*) As a green field venture, in which an altogether a new firm is set up to start operations in a foreign country.<br>(*b*) Acquiring an existing firm in foreign country and using it for manufacturing and promoting its products in home country. |

**Question 8. Distinguish between licensing and franchising.**

**Answer:**

| Basis | Licensing | Franchising |
|---|---|---|
| Meaning | Licensing is a contractual agreement in which one firm grants access to its patents, trade secrets, technology to another firm in a foreign country for a fee. This fee is called royalty. | Franchising is basically a specialized form of licensing in which franchisor sells intangible property to the franchisee but also imposes strict rules on franchisee as to how business is to be done. |
| Connected with | Licensing is used in connection with production and marketing of goods. | The term franchising is used in connection with production of services. |
| Stringency | Licensing is relatively less stringent than franchising. Strict rules and regulations are not set by licensors as to how licensees should operate while running their business. | Franchising is relatively more stringent than licensing. Strict rules and regulations are set by franchisers as to how franchisees should operate while running their business. |

**Question 9. List major items of India's import.**
**Answer:** India's major items of imports include crude oil and petroleum products, capital goods, electronic goods, pearls, precious and semi precious stones, gold, silver and chemicals.

**Question 10.What are the major items that are exported from India?**
**Answer:** India's major items of exports include textiles, garments, gems and jewellery, engineering products and chemicals, agriculture and allied products.

**Question 11. List the major countries with whom India trades.**
**Answer:** India's major trading partners are USA, UK, Germany, Japan, Belgium, Hong Kong, UAE, China, Switzerland, Singapore and Malaysia.

## III. Long Answer Type Questions

**Question 1. What is international business? How is it different from domestic business?**
**Answer:** International business refers to business which is carried on in two or more nations. It means carrying on business activities beyond national boundaries. These activities normally include the transaction of economic resources such as goods, capital, services (comprising technology, skilled labour, and transportation, etc.), and international production. It refers to that business activity that takes place beyond the geographical limits of a country. Production may either involve production of physical goods or provision of services like banking, finance, insurance, construction, trading, and so on. Thus, international business includes not only international trade of goods and services but also foreign investment, especially foreign direct investment.
Differences between International Business and Domestic Business are summarised below:

| Basis | International Business | Domestic Business |
|---|---|---|
| Nationality of buyers and Sellers | People of different nationality participate in international business. | People of one nationality participate in domestic business. Exceptions are possible. |
| Nationality of other stake-holders | Employees, suppliers, customers, shareholders, partners, middlemen etc. belong to different nationality in international business. | Employees, suppliers, customers, shareholders, partners, middlemen etc. belong to same nationality in domestic business. Exceptions are possible. |
| Political Systems | International business is subject to political system of many nations. | Domestic business is subject to political system of one country. |
| Risk | Degree of risk is higher in international business. | Degree of risk is lower as compared to international business. |
| Mobility of factors of production | Mobility of factors of production is less across countries. | Mobility of factors of production is more within geographical boundaries of the country. |
| Consumer's taste and preferences | International markets are heterogeneous in terms of taste and preferences of the customer. | Domestic markets are more homogeneous in terms of taste and preferences of the consumer. |
| Currency | International business involves usage of foreign currency. | Domestic business makes use of domestic currency. |
| Business regulations and policy | International business is subject to rules laws, policies, and taxation system etc of multiple countries. | Domestic business is subject to rules, laws, policies, and taxation system etc of single country. |
| Differences in business systems and practices. | Business systems and policies are heterogeneous in two countries. | Business system and policies are more homogeneous within a country. |

**Question 2. "International business is more than international trade". Comment.**
**Answer:** It is rightly said that international business is more than international trade. The

scope of international business is much wider than international trade. International trade means exports and imports of goods which is an important component of international business but international business includes much more than this. International trade in services like travel and tourism, transportation, communication, banking, warehousing, distribution and advertising is a part of international business. International business also includes foreign direct investments, contract manufacturing, and setting up wholly owned subsidiaries etc. which are not included in international trade. It is clear from the diagram given below:


**Question 3. What benefits do firms derive by entering into international business?**
**Answer:** The trade between two or more nations is termed as foreign trade or international trade. It involves exchange of goods and services between the trades of two countries. Foreign trade consists of import trade, export trade and entrepot trade. In the early stages of human civilization, production was confined as per consumption. Human wants were limited. Nowadays, human wants are increasing and as such no man was considered to be self-dependent. Like this no country can live in isolation and claimed the status to be self-sufficient. Because of this reason countries have trade relationships with each other. The primary objective of foreign trade is to increase foreign trade and increase the standard of living of its people. There is an increasing demand for foreign trade because of the following reasons:

1. The natural resources are unevenly distributed.
2. The presence of specialisation and division of labour.
3. Different countries have difference in economic growth rate.
4. The presence of the theory of comparative cost.
   The following are some of the advantages of foreign trade:

1. **Optimum use of Resources:** Foreign trade helps in the optimum use of natural resources and avoids wastages of resources.
2. **Stable Price:** It ensures the presence of stable price by avoiding wide fluctuations in prices. It tries to equalise the world price.
3. **Availability of all types of goods:** It enables a country to import those goods which it cannot produce.
4. **Increased Standard of living:** It ensures more production to meet the demand of the people of different countries. By increased production, it becomes possible to increase income and the standard of living of its people. It also increases the standard of living by increasing more employment opportunities.
5. **Large Scale production:** It ensures large production because the production is carried on to meet the demand of its people as well as world market. Large scale production also ensures a great deal of internal economies which reduces the cost of production.

**Question 4. In what ways is exporting a better way of entering into international markets than setting up wholly owned subsidiaries abroad.**
**Answer:** Exporting is a better way of entering into international markets than setting up wholly owned subsidiaries abroad in following ways:

1. **Easiest Way:** It is easy to enter international markets through exports as compared to wholly owned subsidiaries.

2. **Less Involving:** It is less involving as compared to establishing a wholly owned subsidiary because firms need not invest that much time and money.
3. **Zero risk of Foreign Investment:** Exporting does not require much of investment in foreign countries. Therefore, foreign investments risks are low as compared to when a firm starts its wholly owned subsidiary in foreign country.
4. **Less Costly:** In a wholly owned subsidiary, 100% equity investment is to be made by foreign company. Therefore, small and medium size producers can't think of this mode of entering into international business.
5. **Risk of Profit and Loss:** In wholly owned subsidiary, 100% equity capital is contributed by foreign company alone. Therefore, it alone has to bear the risk of losses.
6. **Government Intervention:** Some countries are averse to setting up of 100% wholly owned subsidiaries by foreign companies. This form of business operations is subject to high degree of political risks.

**Question 5. Discuss briefly the factors that govern the choice of mode of entry into international business.**
**Answer:** Following factors govern the choice of mode of entry into international business,

1. **Ease of entry:** First and foremost factor that determines the choice of mode of entry into international business is ease of entry. A businessman wants to adopt such mode of entry into international business which is easy and less formalities requiring. Exporting, importing, licensing and franchising are better ways from this perspective.
2. **Cost:** Second determining factor is cost involved. For example, very less cost is involved in exporting, importing, licensing, franchising and contract manufacturing as compared to joint ventures and setting wholly owned subsidiaries.
3. **Control over production:** If the foreign company or producer wants full control over production activities in local country, he will prefer franchising, wholly owned subsidiary or joint venture with majority share holding. If it is not so important, he will prefer exporting, importing, contract manufacturing licensing etc.
4. **Sharing of Technology:** If the company has no problem in sharing of technology then it may choose joint venture or franchising. But if it does not want to share its technology and trade secrets, it will prefer wholly owned subsidiary or exporting,
5. **Risk Involved:** If a firm is ready to take risk, it may choose wholly owned subsidiary or joint ventures but if it is willing to minimize its loss then it should choose exporting, licensing, franchising or contract manufacturing.

**Question 6. Discuss the major trends in India's foreign trade. Also list the major products that India trades with other countries.**
**Answer:** India is 10th largest economy in the world. It is the second fastest growing economy, next only to China. But India's performance in international business is not very good. India's share in world trade in 2003 was just 0.8%. In absolute terms, there has been significant increase in imports as well as exports. Total exports have increased from 606 crores in 1950-51 to Rs. 2, 93,367 crores in 2003-04 while imports have increased from 608 crores in 1950-51 to 3, 59,108 crores in 2003-04. Exports increased 480 times while imports increased 590 times indicating that there is adverse balance of trade. India's major trading partners are USA, UK, Germany, Japan, Belgium, Hong Kong, UAE, China, Switzerland, Singapore and Malaysia.
India's major items of exports include: Textiles, garments, gems and jewellery, engineering products and chemicals, agriculture and allied products.
India's major items of imports include: Crude oil and petroleum products, capital goods, electronic goods, pearls, precious and semi precious stones, gold, silver and chemicals.
Before 1991, promotion of import substitution and discouraging of exports was government strategy. Imports consisted of machinery, equipment and intermediates in production,

petroleum and petroleum-products. After green revolution, imports of fertilizer too increased. Before 1991, India's exports consisted of agricultural products like tea, raw cotton with the diversifying industrial structure, promoted by import substitution, exports of manufactures were growing. During 1986-91, external trade formed only 13.40 % of the GDP. During the 1990-2000, this share is rising continuously.

India's foreign trade has grown to exports of $250 billion and imports of $380 billion in 2010-11. The ratio of exports plus imports to GDP has grown from 13.40 % during 1985-90 to almost three times that, being 37.7 % in 2010-11. On adding services it becomes from 22.9 % in the 1990s to 49.0 % in 2010-11.

Leading role has been played by 'invisibles' which includes both services, mainly software services, export of which has grown to $59 billion in 2010-11. It has decreased the current account deficit from $130 billion to $44. This deficit was compensated by capital account surplus of $59 billion in that year.

But it is only because of IT services and we are still lacking in manufacturing exports which can generate a large volume of employment. We have not done as well as China and Malaysia have done.

**Question 7. What is invisible trade? Discuss salient aspects of India's trade in services.**

**Answer:** Trade in services is called invisible trade. Since services are invisible, export and import of services has been named as invisible trade. In absolute terms, there has been significant increase in India's foreign trade in services. Export and import of foreign travel, transportation and insurance has largely increased during last four decades. There has been a change in composition of services exports. Software and other miscellaneous services have emerged as the main categories of India's export of services. Share of travel and transportation has declined to 29.6% in 2003-04 from 64.3% in 1995-96 while the share of software exports has increased from 10.2% in 1995-96 to 49% in 2003-04.

**Table showing Percentage share of major services to total services exports**

| Sector/Year | 1995-96 | 2000-01 | 2001-02 | 2002-03 | 2003-04 |
|---|---|---|---|---|---|
| Travel | 36.9 | 21.5 | 18.3 | 16.0 | 16.5 |
| Transportation | 27.4 | 12.6 | 12.6 | 12.2 | 13.1 |
| Software | 10.2 | 39.0 | 44.1 | 46.2 | 48.9 |
| Miscellaneous | 22.9 | 21.3 | 20.3 | 22.4 | 18.7 |

The composition of India's external trade has been changing. During 1950s and 60s exports were mainly of primary goods. Over time, the role of engineering goods has been increasing. Overall manufactured goods constitute 66 % of total exports, of which engineering goods are 27%. Textiles and textile products, garments and leather products make around 10 % of India's exports.

In nutshell, we can say that the role of the external or internationally traded goods sector has been growing steadily in Indian economy. At present imports and exports together account for upto 49 % of India's GDP which was 18% in 1990s. In India there is greater share of exports of services which are IT software services, called IT- enabled services (ITES). It contributed more than 20% of India's export earnings. India accounts for about 45% of the world's BPO services. The major Indian IT companies, TCS, Infosys and Wipro, initiated and perfected the Global Services Delivery (GSD) model. It is because India has a vast pool of software engineers and an even bigger pool of English-knowing staff. With growing competition in the market for such services, Indian companies have moved from BPO to Knowledge Process Outsourcing (KPO), which involves providing services for R and D and to high-end consulting.

## I. Very Short Answer Type Questions

**Question 1. Out of international trade and international business which one is wider in scope?**
**Answer:** International business

**Question 2. What is the basic reason behind international trade?**
**Answer:** Comparative cost advantage in production of some goods.

**Question 3. Give one point of difference between licensing and franchising.**
**Answer:** Licensing is used for goods and franchising is used for services.

**Question 4. When a middleman is involved in handling export procedure, then it is called by what name?**
**Answer:** Indirect exporting

**Question 5. Licensee or franchisee pays a fee to licensor or franchisor. What is it called?**
**Answer:** Royalty.

**Question.6. Reebok orders for footballs to local manufacturers of Ludhiana and then sells it all over the world. It is an example of what?**
**Answer:** Contract manufacturing.

**Question 7. Name the country whose share is largest in India's exports and imports.**
**Answer:** USA

**Question 8. What is the share of India's exports in world exports?**
**Answer:** 0.8%

**Question 9. Which service has got dominating share in foreign trade in services?**
**Answer:** Software and Miscellaneous

**Question 10. India is_largest economy in the world.**
**Answer:** 10th

## II. Short Answer Type Questions

**Question 1. Define international business.**
**Answer:** According to Roger Beneett, "International business involves commercial activities that cross national frontiers."
In the words of John D Daniels and Lee H Radebough, "International business is all about business transactions—private and governmental that involve two or more countries. Private companies undertake such transactions for profits; government may or may not do the same in their transactions."
According to Michael R Czinkota, "International business consists of transactions that are devised and carried out across national borders to satisfy the objectives of the individuals, companies and organizations. These transactions take on various forms which are often correlated."

**Question 2. Explain different forms of Joint Ventures.**
**Answer:** A joint venture refers to establishing a firm which is jointly owned by two or more independent firms. It can be entered into three ways:

1. A foreign investor may buy interest in a local company

2. Local firm may acquire an interest in an existing foreign firm.
3. Both local and foreign firms jointly establish a new enterprise.

**Question 3. Explain different forms of contract manufacturing.**
**Answer:** Contract manufacturing can take three forms:

1. **Getting produced certain parts of final products:** In case of automobiles or purses or shoes some parts are got manufactured from foreign countries which are used for the production of final products later.
2. **Assembly of components into final products:** In case of electronic items, different parts are assembled at that country where they are to be sold.
3. **Complete manufacture of the products:** In some cases, commodities like garments a contract is given for complete manufacturing and products are sold in brand name of foreign companies.

**Question 4. India embarks on the path of globalisation. Comment**
**Answer:** Since 1991, with the announcement of New Economic Policy, 1991 India also embarks on the path of globalisation. India was facing a severe financial crisis. It approached International Monetary Fund and World Bank for help. IMF agreed to led money to India on the condition that India will introduce structural changes in its economy. As a result, India announced the policy of LPG i.e. Liberalisation, Privatisation and Globalisation. Then on 1 January, 1995 WTO was formed. India became founder member of WTO and thereby was under a compulsion to follow rules and regulations of WTO. Therefore, it had to open up its economy for rest of the world and they also allowed India to enter their markets. Though the process of reforms has somewhat slowed down, India is very much on the path of globalisation.

**Question 5. What are the benefits of international trade to firms?**
**Answer:** Given below sue benefits of international business for firms:

1. **Prospects for higher profits:** It creates better prospects for higher profits.
2. **Increased capacity utilisation:** It leads to better utilisation of capacity.
3. **Prospects for growth:** It creates better prospects for growth.
4. **Way out to intense competition in domestic market:** International business acts as an alternate when there is intense competition in domestic market.
5. **Improved business vision:** When a business firm acts globally, it gives it an improved business vision.

**Question 6. Write a short note on India’s foreign investments.**
**Answer:** There has been a phenomenal increase in foreign capital inflow and outflow. Inward foreign investments have increased from 201 crores in 1990-91 to 151406 crores in 2003-04. India’s investment in foreign countries has increased from 19 crores in 1990¬91 to 83616 crores in 2003-04.
Inward foreign investments have grown more than 750 times while India’s investment abroad have increased 4927 times.
Table showing inflow and outflow of foreign capital in and from India:

| Year | Inflow | Outflow | Net |
|---|---|---|---|
| 1990-91 | 201 | 19 | 182 |
| 2000-01 | 80824 | 54080 | 26744 |
| 2001-02 | 73907 | 41987 | 31920 |
| 2002-03 | 67756 | 47658 | 22098 |
| 2003-04 | 151406 | 83616 | 67592 |

Question 7. Discuss the merits and demerits of entering into joint ventures.
Answer: Merits of Joint Venture

1. **Less Expensive:** It is.financially less expensive as local producer also makes some contribution in equity capital. Half of the capital is contributed by local producer. It reduces the burden for foreign investor.
2. **Beneficial for projects requiring Large Scale Investment:** It is beneficial for projects requiring large capital investments like construction of metro. In such projects it is generally difficult for a single investor to invest.
3. **Knowledge about host country:** Local producers provide knowledge about host country. It helps the foreign investor to establish its foot in host country.
4. **Less risky:** Risk gets reduced by involving local manufacturer. First, he makes 50% equity and thereby shares losses and other risks. Secondly, he has an understanding of taste and preferences of customers in host country, laws and culture of host country.

Disadvantages of Joint Venture

1. **Sharing of Technology:** In joint venture, foreign firm shares technology with the local producer. It is risky. He may start a business of his own once he gets acquainted with the technology.
2. **Conflicts:** There may be conflicts in managerial decisions as there is dual ownership arrangement.

## III. Long Answer Type Questions

Question 1. Discuss the benefits of international business.
Answer: The benefits of international business to nations are as follows:

1. **Earning of Foreign exchange:** International business helps a country to earn foreign exchange. It can use it for meeting its payments abroad.
2. **Better utilization of resources:** It is based on the principle of comparative cost advantage. It implies that produces what your country can produce more efficiently, and trade the surplus production so generated with other countries to procure what they can produce more efficiently. When countries produce on these principles, it increases their resource utilization.
3. **Improving Growth Prospects and Employment Potentials:** Producing solely for the purpose of domestic consumption severely restricts a country's prospects for growth and employment.
4. **Increased Standard of Living:** In the absence of international trade of goods and services, it would not have been possible to enjoy the standard of living it is enjoying now.

The benefits of international business to firms are as follows:

1. **Prospects for higher profits**: International business proves more profitable as compared

to domestic business. When prices in domestic market are lower, business firms can earn higher profits by selling their products in foreign countries.

2. **Increased Capacity Utilization:** Many firms set up production capacities for their products which are in excess of demand in the domestic market by planning overseas expansion and procuring orders from foreign customers. It allows them to make better use of their surplus capacity.
3. **Prospects for growth:** Business firms find it very irritating when there is fall in demand or saturation point comes in domestic market. Such firms can grow considerable prospects of their growth by entering into international business.
4. **Way out to intense competition in domestic market:** When competition in domestic market is very intense, internationalization seems to be the only way for significant growth. Highly competitive domestic market motivates many firms to enter into international business.
5. **Improved Business Vision:** The growth of international business of many companies is important for their survival and goodwill. Vision to become international is expression of urge to grow and the need to diversify and to take benefit of strategic advantages of internationalisation.

**Question.2. Discuss the scope of international business.**
**Answer.** There are many ways in which the firm's operate international major forms of business operations which constitute international business are given below:

1. **Merchandise exports and imports:** Merchandise means which are tangible. That can be seen and touched. It is also known as trading goods. It excludes trading services.
2. **Exports and Imports of Services:** Service exports and imports involve trade in intangibles. It is because of the intangible aspect of services that trade in services is termed as intangible trade.
3. **Licensing and Franchising:** Permitting another party in a foreign country to produce and sell goods under a firm's trademarks, patents or copyright for which a payment is made which is called royalty is another way of entering into international business. For example, McDonalds'.
4. **Foreign Investments:** Foreign investment is another way to operate internationally. It involves investment of funds abroad in exchange for financial return. It may take two forms:

- **Direct Investment:** It takes place when a company directly invests in property like plant and machinery in foreign countries with a view to undertaking production and marketing of goods and services in these companies.
- **Portfolio Investment:** It is an investment that a company makes into another company by way of acquiring shares or providing loans to the latter.

**Question 3. Licensing and franchising are suitable in different situations. Explain how?**
**Answer:** Yes, it is right to say that licensing and franchising are suitable in different situations. For a company looking to expand, franchising and licensing are often appealing business models. In a franchising model, the franchisee uses another firm's successful business model and brand name to operate what is effectively Em independent branch of the company. The franchiser maintains a considerable degree of control over the operations and processes used by the franchisee, but also helps with things like branding and marketing support that aid the franchise. The franchiser also typically ensures that branches do not cannibalize each other's revenues.
Under a licensing model, a company sells licenses to other (typically smaller) companies to use intellectual property (IP), brand, design or business programs. These licenses are usually

non-exclusive, which means they can be sold to multiple competing companies serving the same market. In this arrangement, the licensing company may exercise control over how its IP is used but does not control the business operations of the licensee.
Both models require that the franchisee/licensee make payments to the original business that owns the brand or intellectual property. There are laws that govern the franchising model and define what constitutes franchising; some agreements end up being legally viewed as franchising even if they were originally drawn up as licensing agreements. It can be clarified from the differences given below:

| Basis | Franchising | Licensing |
|---|---|---|
| Governed by | Securities Law | Contract Law |
| Registration | Required | Not required |
| Territorial rights | Offered to franchisee | Not offered; licensee can sell similar licenses and products in same area |
| Support and training | Provided by franchiser | Not provided |
| Royalty payments | Yes | Yes |
| Use of trademark/Logo | Logo and trademark retained by franchiser and used by franchisee | Can be licensed |
| Examples | McDonalds, Subway, 7-11, Dunkin Donuts | Microsoft Office |
| Control | Franchiser exercises control over franchisee. | Licensor does not have control over licensee. |

**Question 4. Discuss meaning, merits and demerits of contract manufacturing.**
**Answer:** Contract manufacturing refers to type of international business where a firm enters into contract with some local manufactures in foreign countries to get certain components of goods produced as per their specifications. It is also called outsourcing. It can take three forms: Getting produced certain parts of final products which will be used for the production of final products later; assembly of components into final products; and complete manufacture of the products like garments.
**Merits of Contract manufacturing**

1. **Less investment:** It helps international firms in production of goods at massive scale without making any investment in setting up production facilities. Therefore, it is more suitable for small and medium size manufacturers who can't undertake 100% or even 50% investment.
2. **Less risky:** It is less risky as there is little investment involved. Moreover, local manufacturers who have been given specific product design and quality standards do not deviate from them.
3. **Low cost:** If goods are contracted in low labour and material cost country, then it also gives benefit of low cost. For example, in India labour is very cheap and therefore it has become a favorite destination for contract manufacturing.
4. **Better capacity utilization:** Local producers benefit get from contract manufacturing because it allows them to make better use of their idle production capacity.
5. **An opportunity for local producers to become international:** Local producer also gets an opportunity to get involved in international business.

**Disadvantages of Contract Manufacturing**

1. **Deviations from Product design and quality Specifications:** Local firms might not follow product design and quality standards causing serious product quality problems for international firm.

2. **Loses control over Manufacturing Process:** Local manufacturer in the foreign country loses control over manufacturing process.
3. **No authority to sell output:** The local firm cannot sell the output according to his will. It has to sell the goods to international firm at pre-determined prices.

**Question 5. State the important changes being observed in composition of India's external trade since 2007-08.**

**Answer:** Till 1980's exports were mainly of primary goods, viz. agricultural commodities and raw materials, such as minerals. Over time, the role of manufactures including engineering goods has been increasing. Share of manufactured goods is 66 % of total exports, of which engineering goods contribute 27 % of the value of goods exported. Composition of India's external trade since 2007-08 is shown below:

**India's Exports and Imports (US$ billion).**

| | 2007-08 | % share | 2010-11 | % share |
|---|---|---|---|---|
| Exports | | | | |
| (1) Primary Products | 27.55 | 16.91 | 35.35 | 13.89 |
| (*a*) Agricultural and allied | 18.43 | 11.31 | 24.69 | 9.70 |
| (*b*) Ores and minerals | 9.11 | 5.59 | 10.66 | 4.19 |
| (2) Manufactured Goods | 102.97 | 63.21 | 168.09 | 66.07 |
| (*a*) Leather and Manufactures | 3.50 | 21.48 | 3.78 | 1.48 |
| (*b*) Chemicals and related items | 21.19 | 13.00 | 28.79 | 11.31 |
| (*c*) Engineering goods | 19.42 | 11.92 | 23.31 | 9.16 |
| (*d*) Textiles and products | 19.42 | 11.92 | 23.31 | 9.16 |
| (*e*) Gems and jewellery | 19.67 | 12.07 | 40.79 | 16.03 |
| (*f*) Handicrafts | 0.50 | 0.30 | 0.23 | 0.09 |
| (3) Petroleum products | 28.36 | 17.40 | 41.91 | 16.47 |
| Total exports Imports | 162.90 | | 254.40 | |
| (1) Bulk imports | 112.74 | 44.83 | 150.48 | 42.60 |
| (*a*) Petroleum | 79.64 | 31.67 | 106.06 | 30.08 |
| (2) Non-bulk Imports | 138.69 | 55.16 | 202.08 | 57.31 |
| (*a*) Capital goods | 70.11 | 27.88 | 71.62 | 20.31 |
| (*b*) Mainly export related | 20.76 | 8.25 | 49.63 | 14.07 |
| Total Imports | 251.43 | | 352.57 | |

**Source:** *RBI, Annual Report, 2010-11, Appendix Table 17, p. 186.*

**Question 6. "Wholly owned subsidiary is a more investing, more risky and less return giving venture." Do you agree? Substantiate your answer.**

**Answer:** I agree to the statement partially. Wholly owned subsidiary is a more investing, more risky and more return giving venture. In this the parent company acquires the full control over the foreign company by purchasing its 100% equity capital. It can be established in two ways: first as a green field venture, in which an altogether a new firm is set up to start operations in a foreign existing firm in foreign country and using it for manufacturing and promoting its products in home country.

**Merits of Wholly Owned Subsidiaries**

1. **Complete control over operations:** The parent firm is able to exercise full control over its operations in foreign countries because it has 100% equity holding in the company.
2. **No need to disclose technology:** It is less risky as 100% investment is made by parent company and hence there is no need to disclose technology to local producers.

**Demerits of Wholly Owned Subsidiaries**

1. **100% Investment and hence require more funds:** The parent company needs to make 100% equity investment and therefore requires huge funds.
2. **More risky:** It is more risky as parent company has 100% equity investment; it has to

bear all the losses, if any.

3. **Government rules and regulations:** Some countries do not allow establishing 100% wholly owned subsidiaries in their countries.

**Question 7. How is home trade different from external trade?**
**Answer:** Internal trade takes place between the geographical boundaries of a nation, whereas international trade takes place between different nations.

1. In the trade of any nation, the volume of its internal trade will be more than that of external trade. Internal trade accounts for about 95% of the total volume of the trade of a country, whereas foreign trade accounts for only about 5% of the total volume of the trade of a country.
2. Though both internal trade and international trade are based on the principle of specialization or division of labour, regional specialization within a country leads to internal trade or inter-regional trade, whereas country wise specialization leads to international trade.
3. In the case of home trade, there is much scope for the operation of forces of demand and supply. But, in the case of foreign trade, there is not much scope for the full operation of the forces of demand and supply.
4. The number of documents of trade required for home trade is less than the required for foreign trade.
5. Home trade is subject to regulations and laws of only one country, whereas foreign trade is subject to regulations and laws of two or more countries.
6. Home trade is, generally, free from restrictions, whereas foreign trade is subject to a number of restrictions.
7. The cost of transport in home trade is much less than that in foreign trade.
8. The interval between the dispatch of goods by the seller and the receipt of the same by the buyer in home trade is not much.
9. Goods are subject to greater risk in foreign trade than in home trade.
10. As goods are subject to more risks in foreign trade, in the case of international trader, goods are, generally, insured against the risks.
11. Home trade involves the currency of only one country whereas foreign trade involves the currencies of two or more countries.

## IV. Higher Order Thinking Skills (HOTS)

**Question 1. "Foreign trade is not free from difficulties." Comment.**
**Answer:** Foreign trade is not free from difficulties. The following are some of the important difficulties of foreign trade:

1. It is a long distance trade and as such it becomes difficult to maintain close relationship between the buyer and the seller.
2. Each country has its own language. As foreign trade involves trade between two or more countries, there is diversity of languages. This difference in language creates problem in foreign trade,
3. Foreign trade involves preparation of a number of documents which also creates difficulties in the way of foreign trade.
4. Some restrictions are imposed on export and import of commodities. These restrictions stand on the progress of foreign trade.
5. Foreign trade involves a great deal of risks because trade takes place over a long distance. Though the risks are covered through insurance, it involves extra cost of production because insurance cost is added to cost.

**Question 2. "International trade benefits both the parties involve." Do you agree? Justify your answer:**
**Answer.** No doubt, trade benefits both the parties involved. These gains can be categorised as static and dynamic.
**Static gains from trade:**

1. If a country has an absolute or relative advantage in the production of some goods, it can specialize in those goods and can trade it for others. It will increase total productivity.
2. Increase in imports will increase country's ability to satisfy consumer needs. Imports of capital goods may also increase the economic growth rate in the initial stages. It may also shift economy closer to its production possibility curve indicating relatively fuller utilization of resources.
3. Specialization based on comparative advantage will result more efficient utilization of resources. Hence, a labour abundant country will expand those industries which use more of labour. It will stimulate employment and wage rates will go up.
4. According to Myint, international trade can provide a larger market for developing countries that will help these countries to increase their output and employment and hence, they will shift closer to PPC and real output will increase.
5. Trade brings various nations closer and interlinks the economies of the world. It helps to learn from each other's experience and sharing of capital, technology and knowhow also increases.

**Negative static effects of trade:**

1. An economy which specialises in labour intensive industries at the cost of modern sector may face problems. It is so because the products of these industries have low price elasticities of demand and supply of agriculture and primary goods is quite instable.
2. Large chunks of stock will lead to unfavorable terms of trade for the country. It may reduce the benefits expected from trade.
3. Specializing in labour intensive industries and relying on developed nations for modern machinery and commodities is not advisable on the principle of prudence.
4. Since there is huge unemployment in developing countries, increased demand for labour will not increase wage rate so much.
5. Since there are inflexibilities in traditional economies, the expected gains from trade do not get realized. Rather trade benefits developed countries more and thereby increases the inequalities of income amongst nations.
   Dynamic gains from trade:

**Dynamic positive effects:**

1. When economy operates at a larger scale with access to the markets of other countries, it can avail of economies of scale which otherwise will not be available.
   Economies of large scale will make these countries more competitive in international market.
2. International trade gives*an exposure to world market and international technology of production which a closed economy can not have. It helps an under developed country to grow at a fast pace and become more competitive.
3. There are many other dynamic changes that occur in the economy via trade like increased investment due to better economic environment, approach to world class technology, institutional changes, exposure to new and different products.

**Dynamic negative effects:**

1. Market imperfections may increase social costs. Hence, trade that considers only private costs may not be consistent with the long term development goals.
2. The overall effect of exports will vary from industry to industry; sector to sector. Some industries may get benefit more than others.
3. If increasing returns to scale are available for some commodity, it may lead to higher profits through exports rather than one in which decreasing returns to scale are expected. Hence, returns to scale may complicate the judgment whether exports are benefiting or not.
4. Existence of imperfection in markets and government policies may adversely affect the expected dynamic gains.
5. Many a time, trade benefits developed countries more than developing ones. In such a situation, it may worsen the relative economic strength of developing nations.

## V. Value Based Questions

**Question 1. Which mode of international business should be chosen by a small business man and why?**

**Answer:** A small business should consider following factors in selecting mode of entering into international business.

1. **Ease of entry:** First and foremost factor that determines the choice of mode of entry into international business is ease of entry. A businessman wants to adopt such mode of entry into international business which is easy and less formalities requiring. Exporting, importing, licensing and franchising are better ways from this perspective.
2. **Cost:** Second determining factor is cost involved. For example, very less cost is involved in exporting, importing, licensing, franchising and contract manufacturing as compared to joint ventures and setting wholly owned subsidiaries.
3. **Control over production:** If the foreign company or producer wants full control over production activities in local country, he will prefer franchising, wholly owned subsidiary or joint venture with majority share holding. If it is not so important, he will prefer exporting, importing, contract manufacturing licensing etc.
4. **Sharing of Technology:** If the company has no problem in sharing of technology then it may choose joint venture or franchising. But if it does not want to share its technology and trade secrets, it will prefer wholly owned subsidiary or exporting.
5. **Risk Involved**: If a firm is ready to take risk, it may choose wholly owned subsidiary or joint ventures but if it is willing to minimise its loss then it should choose exporting, licensing, franchising or contract manufacturing.
   In my opinion, being a small businessman he will prefer exporting or licensing,franchising to other modes of business as it is easy, less costly, gives greater control over production and involves lesser risk.