Exploring Global Business

3

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Learning Objectives

What you will be able to do once you complete this chapter:

1. Explain the economic basis for international business.
2. Discuss the restrictions nations place on international trade, the objectives of these restrictions, and their results.
3. Outline the extent of international business and the world economic outlook for trade.
4. Discuss international trade agreements and international economic organizations working to foster trade.
5. Define the methods by which a firm can organize for and enter into international markets.
6. Describe the various sources of export assistance.
7. Identify the institutions that help firms and nations finance international business.

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FYI

inside business

Did You Know?

Once a small firm in South Korea exporting food products to China, Samsung Electronics now makes more television sets than any other manufacturer on the planet and rings in $110 billion in annual sales.

Samsung Electronics Shines in the Global Spotlight

In the 40 years since Samsung Electronics made its first television set, the South Korean company has more than lived up to the shining success suggested by its name (which translates as *three stars*). Samsung started as a small firm specializing in exporting food products to China and later branched out into the insurance industry. By 1970, the unit that would become Samsung Electronics was manufacturing black and white televisions and was readying plans to produce additional household and business products for the global marketplace.

Today Samsung Electronics has grown into an international corporation offering everything from cameras and computers to cell phones and semiconductors, even dishwashers and disk drives. It makes more television sets than any other manufacturer on the planet and has long been the market leader in memory chips for computers. It sells more than 200 million cell phones every year, putting it second only to Finland's Nokia in worldwide output. With $110 billion in annual sales and 164,000 employees, Samsung Electronics is a shining star of the global economy.

The electronics industry is intensely competitive, with local firms and global giants, such as Apple, Hewlett-Packard, Intel, and Motorola, fighting for sales on every continent. In fact, Samsung Electronics' main rival in LCD (liquid crystal display) screens is LG, another South Korean company that has prospered by expanding worldwide. Despite its strong competitive position, however, Samsung Electronics is not immune to world economic troubles, and it lost money for a brief period during the recent downturn. Yet, because the company owns and operates its own factories, it was able to control costs and reduce production as soon as the economy started to slow.

To keep its business growing, Samsung Electronics pursues innovation through research and development centers in the United States, Europe, India, and China. It also participates in joint ventures that tackle cutting-edge manufacturing challenges. For example, it is partnered with Sony to jointly own and operate three South Korean factories that produce advanced flat-panel television displays. Looking ahead to a greener future, Samsung Electronics is designing products that are easier on the environment, cutting greenhouse gas emissions, and helping suppliers do business in more sustainable ways.[1]

Samsung Electronics is just one of a growing number of foreign companies, large and small, that are doing business with firms in other countries. Some companies, such as Coca-Cola, sell to firms in other countries; others, such as Pier 1 Imports, buy goods around the world to import into the United States. Whether they buy or sell products across national borders, these companies are all contributing to the volume of international trade that is fueling the global economy.

Theoretically, international trade is every bit as logical and worthwhile as interstate trade between, say, California and Washington. Yet, nations tend to restrict the import of certain goods for a variety of reasons. For example, in the early 2000s, the United States restricted the import of Mexican fresh tomatoes because they were undercutting price levels of domestic fresh tomatoes.

Despite such restrictions, international trade has increased almost steadily since World War II. Many of the industrialized nations have signed trade agreements intended to eliminate problems in international business and to help less-developed nations participate in world trade. Individual firms around the world have seized the opportunity to compete in foreign markets by exporting products and increasing foreign production, as well as by other means.

Signing the Trade Act of 2002, President George W. Bush remarked, "Trade is an important source of good jobs for our workers and a source of higher growth for our economy. Free trade is also a proven strategy for building global prosperity and adding

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to the momentum of political freedom. Trade is an engine of economic growth. In our lifetime, trade has helped lift millions of people and whole nations out of poverty and put them on the path of prosperity".[2] In his national best seller, *The World Is Flat,* Thomas L. Friedman states, "The flattening of the world has presented us with new opportunities, new challenges, new partners but, also, alas new dangers, particularly as Americans it is imperative that we be the best global citizens that we can be—because in a flat world, if you don't visit a bad neighborhood, it might visit you."

We describe international trade in this chapter in terms of modern specialization, whereby each country trades the surplus goods and services it produces most efficiently for products in short supply. We also explain the restrictions nations place on products and services from other countries and present some of the possible advantages and disadvantages of these restrictions. We then describe the extent of international trade and identify the organizations working to foster it. We describe several methods of entering international markets and the various sources of export assistance available from the federal government. Finally, we identify some of the institutions that provide the complex financing necessary for modern international trade.

The Basis for International Business

1

Explain the economic basis for international business.

International business encompasses all business activities that involve exchanges across national boundaries. Thus, a firm is engaged in international business when it buys some portion of its input from, or sells some portion of its output to, an organization located in a foreign country. (A small retail store may sell goods produced in some other country. However, because it purchases these goods from American distributors, it is not engaged in international trade.)

Absolute and Comparative Advantage

international business all business activities that involve exchanges across national boundaries

absolute advantage the ability to produce a specific product more efficiently than any other nation

comparative advantage the ability to produce a specific product more efficiently than any other product

Some countries are better equipped than others to produce particular goods or services. The reason may be a country's natural resources, its labor supply, or even customs or a historical accident. Such a country would be best off if it could specialize in the production of such products so that it can produce them most efficiently. The country could use what it needed of these products and then trade the surplus for products it could not produce efficiently on its own.

Saudi Arabia thus has specialized in the production of crude oil and petroleum products; South Africa, in diamonds; and Australia, in wool. Each of these countries is said to have an absolute advantage with regard to a particular product. An **absolute advantage** is the ability to produce a specific product more efficiently than any other nation.

One country may have an absolute advantage with regard to several products, whereas another country may have no absolute advantage at all. Yet it is still worthwhile for these two countries to specialize and trade with each other. To see why this is so, imagine that you are the president of a successful manufacturing firm and that you can accurately type 90 words per minute. Your assistant can type 80 words per minute but would run the business poorly. Thus, you have an absolute advantage over your assistant in both typing and managing. However, you cannot afford to type your own letters because your time is better spent in managing the business. That is, you have a **comparative advantage** in managing. A comparative advantage is the ability to produce a specific product more efficiently than any other product.

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Exploiting absolute advantage. Saudi Arabia and Siberia have long specialized in the production of crude oil and petroleum products. Because of their natural oil resources, Siberia, Saudi Arabia, and other countries in the Middle East enjoy an absolute advantage—their ability to produce petroleum products more efficiently than any other area of the world.

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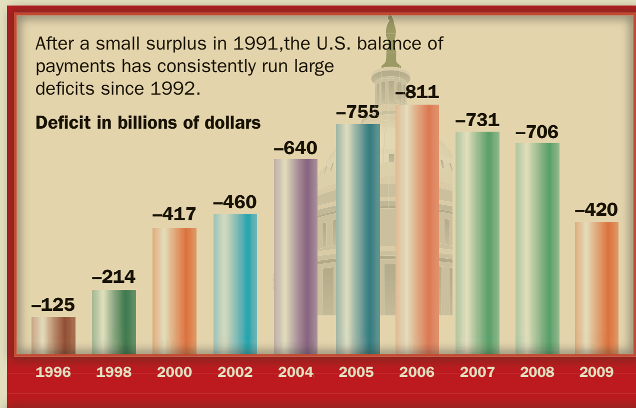
SPOTLIGHT

The Growing Deficit



Source: U.S. Department of Commerce, Bureau of Economic Analysis, http://bea.gov/newsreleases/rels.htm, April 22, 2010.

Your assistant, on the other hand, has a comparative advantage in typing because he or she can do that better than managing the business. Thus, you spend your time managing, and you leave the typing to your assistant. Overall, the business is run as efficiently as possible because you are each working in accordance with your own comparative advantage.

The same is true for nations. Goods and services are produced more efficiently when each country specializes in the products for which it has a comparative advantage. Moreover, by definition, every country has a comparative advantage in some product. The United States has many comparative advantages—in research and development, high-technology industries, and identifying new markets, for instance.

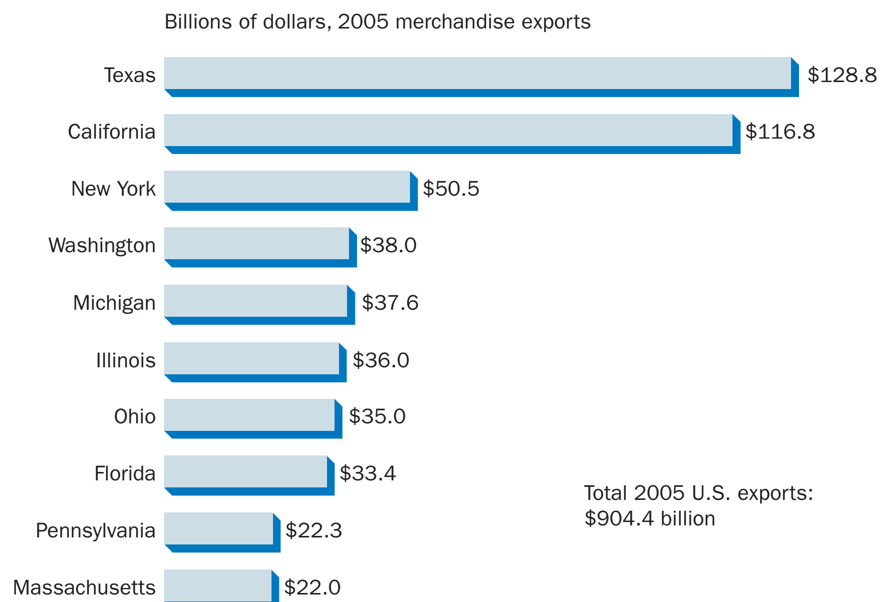
Exporting and Importing

Suppose that the United States specializes in producing corn. It then will produce a surplus of corn, but perhaps it will have a shortage of wine. France, on the other hand, specializes in producing wine but experiences a shortage of corn. To satisfy both needs—for corn and for wine—the two countries should trade with each other. The United States should export corn and import wine. France should export wine and import corn.

Exporting is selling and shipping raw materials or products to other nations. The Boeing Company, for example, exports its airplanes to a number of countries for use by their airlines. Figure 3.1 shows the top ten merchandise-exporting states in this country.

exporting selling and shipping raw materials or products to other nations

Figure 3.1 The Top Ten Merchandise-Exporting States



Source: http://www.ita.doc.gov/td/industry/otea/state/2005_year_end_dollar_value_05.html (accessed May 23, 2010).

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Importing is purchasing raw materials or products in other nations and bringing them into one's own country. Thus, buyers for Macy's department stores may purchase rugs in India or raincoats in England and have them shipped back to the United States for resale.

Importing and exporting are the principal activities in international trade. They give rise to an important concept called the *balance of trade*. A nation's **balance of trade** is the total value of its exports minus the total value of its imports over some period of time. If a country imports more than it exports, its balance of trade is negative and is said to be *unfavorable*. (A negative balance of trade is unfavorable because the country must export money to pay for its excess imports.)

In 2009, the United States imported $1,933 billion worth of goods and services and exported $1,555 billion worth. It thus had a trade deficit of $378 billion. A **trade deficit** is a negative balance of trade (see Figure 3.2). However,

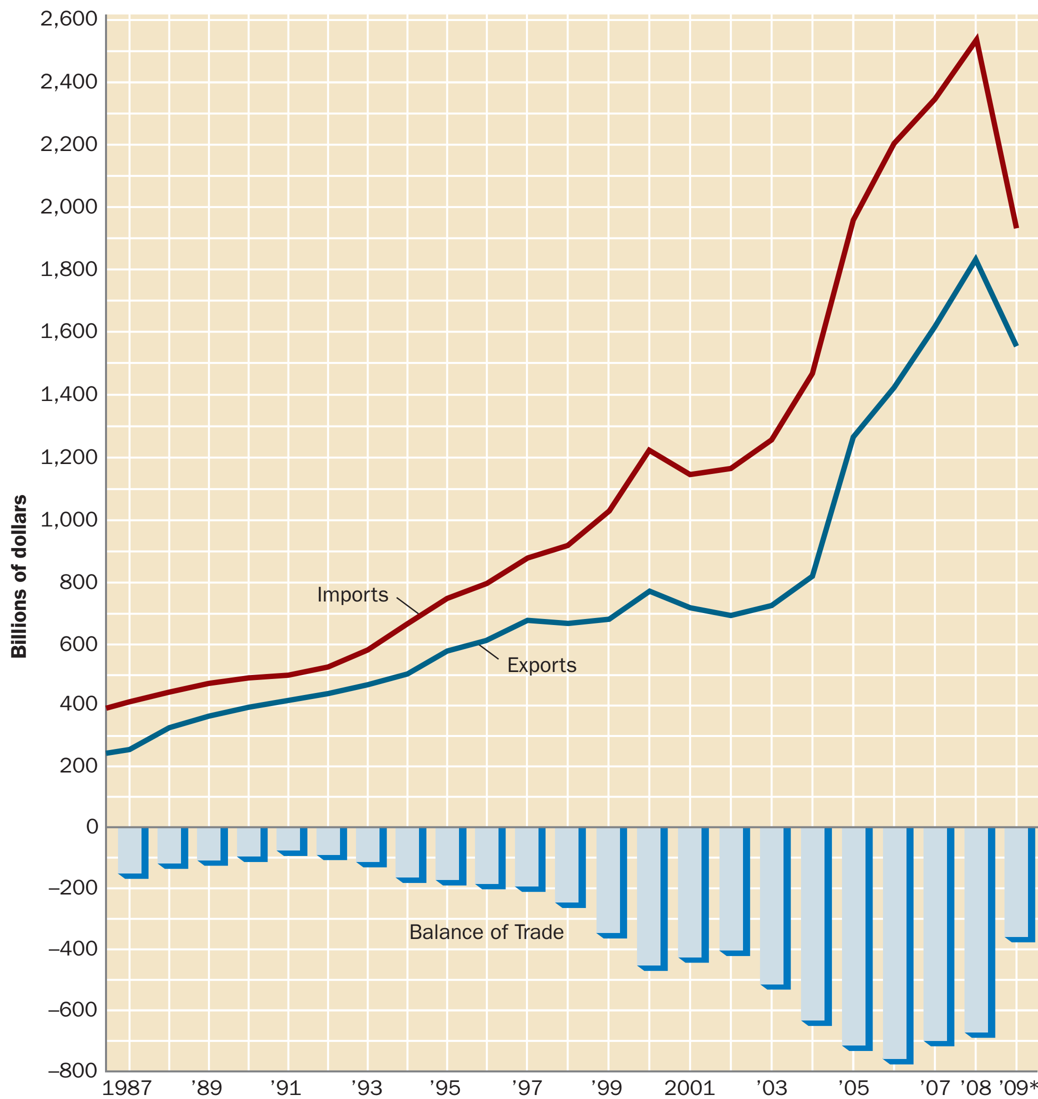
importing purchasing raw materials or products in other nations and bringing them into one's own country

balance of trade the total value of a nation's exports minus the total value of its imports over some period of time

trade deficit a negative balance of trade

Figure 3.2 U.S. International Trade in Goods and Services

If a country imports more goods than it exports, the balance of trade is negative, as it was in the United States from 1987 to 2007.



*Preliminary

Source: U.S. Department of Commerce, International Trade Administration, U.S. Bureau of Economic Analysis, http://bea.gov/international/bp_web/simple.cfm?anon=90730&table_id=1&area_id=3 (accessed July 25, 2010).

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the United States has consistently enjoyed a large and rapidly growing surplus in services. For example, in 2009, the United States imported $371 billion worth of services and exported $509 billion worth, thus creating a favorable balance of $138 billion.[3]

Question: *Are trade deficits bad?*

Answer: In testimony before the Senate Finance Committee, Daniel T. Griswold, associate director of the Center for Trade Policy at the Cato Institute, remarked, "The trade deficit is not a sign of economic distress, but of rising domestic demand and investment. Imposing new trade barriers will only make Americans worse off while leaving the trade deficit virtually unchanged."

On the other hand, when a country exports more than it imports, it is said to have a *favorable* balance of trade. This has consistently been the case for Japan over the last two decades or so.

A nation's **balance of payments** is the total flow of money into a country minus the total flow of money out of that country over some period of time. Balance of payments, therefore, is a much broader concept than balance of trade. It includes imports and exports, of course. However, it also includes investments, money spent by foreign tourists, payments by foreign governments, aid to foreign governments, and all other receipts and payments.

A continual deficit in a nation's balance of payments (a negative balance) can cause other nations to lose confidence in that nation's economy. Alternatively, a continual surplus may indicate that the country encourages exports but limits imports by imposing trade restrictions.

2

Discuss the restrictions nations place on international trade, the objectives of these restrictions, and their results.

Restrictions to International Business

Specialization and international trade can result in the efficient production of want-satisfying goods and services on a worldwide basis. As we have noted, international business generally is increasing. Yet the nations of the world continue to erect barriers to free trade. They do so for reasons ranging from internal political and economic pressures to simple mistrust of other nations. We examine first the types of restrictions that are applied and then the arguments for and against trade restrictions.

Types of Trade Restrictions

Nations generally are eager to export their products. They want to provide markets for their industries and to develop a favorable balance of trade. Hence, most trade restrictions are applied to imports from other nations.

Tariffs Perhaps the most commonly applied trade restriction is the customs (or import) duty. An **import duty** (also called a **tariff**) is a tax levied on a particular foreign product entering a country. For example, the United States imposes a 2.2 percent import duty on fresh Chilean tomatoes, an 8.7 percent duty if tomatoes are dried and packaged, and nearly 12 percent if tomatoes are made into ketchup or salsa. The two types of tariffs are revenue tariffs and protective tariffs; both have the effect of raising the price of the product in the importing nations, but for different reasons. *Revenue tariffs* are imposed solely to generate income for the government. For example, the United States imposes a duty on Scotch whiskey solely for revenue purposes. *Protective tariffs,* on the other hand, are imposed to protect a domestic industry from competition by keeping the price of competing imports level with or higher than the price of similar domestic products. Because fewer units of the product will be sold at the increased price, fewer units will be imported. The French and Japanese agricultural sectors would both shrink drastically if their nations abolished the protective tariffs that keep the price of

balance of payments the total flow of money into a country minus the total flow of money out of that country over some period of time

import duty (tariff) a tax levied on a particular foreign product entering a country

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imported farm products high. Today, U.S. tariffs are the lowest in history, with average tariff rates on all imports under 3 percent.

Some countries rationalize their protectionist policies as a way of offsetting an international trade practice called *dumping*. **Dumping** is the exportation of large quantities of a product at a price lower than that of the same product in the home market.

Thus, dumping drives down the price of the domestic item. Recently, for example, the Pencil Makers Association, which represents eight U.S. pencil manufacturers, charged that low-priced pencils from Thailand and the People's Republic of China were being sold in the United States at less than fair value prices. Unable to compete with these inexpensive imports, several domestic manufacturers had to shut down. To protect themselves, domestic manufacturers can obtain an antidumping duty through the government to offset the advantage of the foreign product. In 2010, for example, the U.S. Department of Commerce imposed antidumping duties of up to 99 percent on a variety of steel products imported from China, following allegations by U.S. Steel Corp. and other producers that the products were being dumped at unfair prices.

The United States-Brazil cotton dispute. After a series of fruitless discussions between the United States and Brazil, the World Trade Organization ruled that the United States and European Union have been dumping cotton in developing countries, hurting poor farmers in the developing country.

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Nontariff Barriers

A **nontariff barrier** is a nontax measure imposed by a government to favor domestic over foreign suppliers. Nontariff barriers create obstacles to the marketing of foreign goods in a country and increase costs for exporters. The following are a few examples of government-imposed nontariff barriers:

- An **import quota** is a limit on the amount of a particular good that may be imported into a country during a given period of time. The limit may be set in terms of either quantity (so many pounds of beef) or value (so many dollars' worth of shoes). Quotas also may be set on individual products imported from specific countries. Once an import quota has been reached, imports are halted until the specified time has elapsed.
- An **embargo** is a complete halt to trading with a particular nation or of a particular product. The embargo is used most often as a political weapon. At present, the United States has import embargoes against Iran and North Korea—both as a result of extremely poor political relations.
- A **foreign-exchange control** is a restriction on the amount of a particular foreign currency that can be purchased or sold. By limiting the amount of foreign currency importers can obtain, a government limits the amount of goods importers can purchase with that currency. This has the effect of limiting imports from the country whose foreign exchange is being controlled.
- A nation can increase or decrease the value of its money relative to the currency of other nations. **Currency devaluation** is the reduction of the value of a nation's currency relative to the currencies of other countries.

Devaluation increases the cost of foreign goods, whereas it decreases the cost of domestic goods to foreign firms. For example, suppose that the British pound is worth $2. In this case, an American-made $2,000 computer can be purchased for £1,000. However, if the United Kingdom devalues the pound so that it is worth only $1, that same computer will cost £2,000. The increased cost, in pounds, will reduce the import of American computers—and all foreign goods—into England.

On the other hand, before devaluation, a £500 set of English bone china will cost an American $1,000. After the devaluation, the set of china will cost only $500. The

dumping exportation of large quantities of a product at a price lower than that of the same product in the home market

nontariff barrier a nontax measure imposed by a government to favor domestic over foreign suppliers

import quota a limit on the amount of a particular good that may be imported into a country during a given period of time

embargo a complete halt to trading with a particular nation or in a particular product

foreign-exchange control a restriction on the amount of a particular foreign currency that can be purchased or sold

currency devaluation the reduction of the value of a nation's currency relative to the currencies of other countries

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Restrictions or not, international business is booming. Globalization is the reality of our time. As trade barriers decrease, ever-increasing numbers of U.S. companies are entering the global marketplace, creating more choices for consumers.

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decreased cost will make the china—and all English goods—much more attractive to U.S. purchasers. Bureaucratic red tape is more subtle than the other forms of nontariff barriers. Yet it can be the most frustrating trade barrier of all. A few examples are the unnecessarily restrictive application of standards and complex requirements related to product testing, labeling, and certification.

Another type of nontariff barrier is related to cultural attitudes. Cultural barriers can impede acceptance of products in foreign countries. For example, illustrations of feet are regarded as despicable in Thailand. When customers are unfamiliar with particular products from another country, their general perceptions of the country itself affect their attitude toward the product and help to determine whether they will buy it. Because Mexican cars have not been viewed by the world as being quality products, Volkswagen, for example, may not want to advertise that some of its models sold in the United States are made in Mexico. Many retailers on the Internet have yet to come to grips with the task of designing an online shopping site that is attractive and functional for all global customers.

Reasons for Trade Restrictions

Various reasons are given for trade restrictions either on the import of specific products or on trade with particular countries. We have noted that political considerations usually are involved in trade embargoes. Other frequently cited reasons for restricting trade include the following:

- *To equalize a nation's balance of payments*. This may be considered necessary to restore confidence in the country's monetary system and in its ability to repay its debts.
- *To protect new or weak industries*. A new, or *infant*, industry may not be strong enough to withstand foreign competition. Temporary trade restrictions may be used to give it a chance to grow and become self-sufficient. The problem is that once an industry is protected from foreign competition, it may refuse to grow, and "temporary" trade restrictions will become permanent. For example, a recent report by the Government Accountability Office (GAO), the congressional investigative agency, has accused the federal government of routinely imposing quotas on foreign textiles without "demonstrating the threat of serious damage" to U.S. industry. The GAO said that the Committee for the Implementation of Textile Agreements sometimes applies quotas even though it cannot prove the textile industry's claims that American companies have been hurt or jobs have been eliminated.
- *To protect national security.* Restrictions in this category generally apply to technological products that must be kept out of the hands of potential enemies. For example, strategic and defense-related goods cannot be exported to unfriendly nations.
- *To protect the health of citizens*. Products may be embargoed because they are dangerous or unhealthy (e.g., farm products contaminated with insecticides).
- *To retaliate for another nation's trade restrictions*. A country whose exports are taxed by another country may respond by imposing tariffs on imports from that country.
- *To protect domestic jobs*. By restricting imports, a nation can protect jobs in domestic industries. However, protecting these jobs can be expensive. For example, protecting 9,000 jobs in the U.S. carbon-steel industry costs $6.8 billion, or $750,000 per job. In addition, Gary Hufbauer and Ben Goodrich, economists at the Institute for International Economics, estimate that the tariffs could

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temporarily save 3,500 jobs in the steel industry, but at an annual cost to steel users of $2 billion, or $584,000 per job saved. Yet recently the United States imposed tariffs of up to 616 percent on steel pipes imported from China, South Korea, and Mexico. Similarly, it is estimated that we spent more than $100,000 for every job saved in the apparel manufacturing industry—jobs that seldom paid more than $35,000 a year.

Reasons Against Trade Restrictions

Trade restrictions have immediate and long-term economic consequences—both within the restricting nation and in world trade patterns. These include the following:

- *Higher prices for consumers.* Higher prices may result from the imposition of tariffs or the elimination of foreign competition, as described earlier. For example, imposing quota restrictions and import protections adds $25 billion annually to U.S. consumers' apparel costs by directly increasing costs for imported apparel.
- *Restriction of consumers' choices.* Again, this is a direct result of the elimination of some foreign products from the marketplace and of the artificially high prices that importers must charge for products that are still imported.
- *Misallocation of international resources.* The protection of weak industries results in the inefficient use of limited resources. The economies of both the restricting nation and other nations eventually suffer because of this waste.
- *Loss of jobs.* The restriction of imports by one nation must lead to cutbacks—and the loss of jobs—in the export-oriented industries of other nations. Furthermore, trade protection has a significant effect on the composition of employment. U.S. trade restrictions—whether on textiles, apparel, steel, or automobiles—benefit only a few industries while harming many others. The gains in employment accrue to the protected industries and their primary suppliers, and the losses are spread across all other industries. A few states gain employment, but many other states lose employment.

The Extent of International Business

3

Outline the extent of international business and the world economic outlook for trade.

Restrictions or not, international business is growing. Although the worldwide recessions of 1991 and 2001–2002 slowed the rate of growth, and the 2008–2009 global economic crisis caused the sharpest decline in more than 70 years, globalization is a reality of our time. In the United States, international trade now accounts for over one-fourth of GDP. As trade barriers decrease, new competitors enter the global marketplace, creating more choices for consumers and new opportunities for job seekers. International business will grow along with the expansion of commercial use of the Internet.

The World Economic Outlook for Trade

Although the global economy continued to grow robustly until 2007 economic performance was not equal: growth in the advanced economies slowed and then stopped in 2009, whereas emerging and developing economies continued to grow. Looking ahead, the International Monetary Fund (IMF), an international bank with 186 member nations, expected growth to continue in 2010 and 2011 in both advanced and emerging developing economies.[4]

Although the U.S. economy had been growing steadily since 2000 and recorded the longest peacetime expansion in the nation's history, the worldwide recession which began in December 2007 has slowed the rate of growth. The IMF estimated that the U.S. economy grew by less than half of 1 percent in 2008 and, because of subprime mortgage lending and other global financial problems, declined 2.5 percent in 2009. International experts expected global economic growth of 3.9 percent in 2010 and 4.3 percent in 2011, despite the high oil prices.

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Canada and Western Europe Our leading export partner, Canada, is projected to show a growth rate of 2.6 percent in 2010 and 3.6 percent in 2011. The euro area, which declined by 3.9 percent in 2009, grew by 1.0 percent in 2010, and is expected to grow 1.6 percent in 2011. The United Kingdom and smaller European countries, such as Austria, the Netherlands, Sweden, and Switzerland, are expected to experience a recession.

Mexico and Latin America Our second-largest export customer, Mexico, suffered its sharpest recession ever in 1995, and experienced another major setback in 2009. However, its growth rate in 2010 and 2011 is expected to be 4.0 percent and 4.7 percent, respectively. Brazil escaped the recent global economic crisis with only minor setbacks: its growth in 2008 was more than 5 percent, and in 2009 it declined only 0.4 percent. Growth of about 4.7 percent and 3.7 percent is expected in 2010 and 2011, respectively. In general, the Latin American and the Caribbean economies are recovering at a robust pace.

Japan Japan's economy is regaining momentum. Stronger consumer demand and business investment make Japan less reliant on exports for growth. The IMF estimates the growth for Japan at 1.7 percent in 2010 and 2.2 percent in 2011.

Other Asian Countries The economic growth in Asia remained strong in 2008 and 2009 despite the global recession. Growth was led by China, where its economy expanded by 8.7 percent in 2009, and is expected to grow at 10 percent and 9.7 percent in 2010 and 2011, respectively. Growth in India slowed modestly to 5.6 percent in 2009, but is predicted to grow at 7.7 percent and 7.8 percent in 2010 and 2011, respectively. Growth in Indonesia, Malaysia, the Philippines, Thailand, and Vietnam is expected at 4.7 percent and 5.3 percent in 2010 and 2011, respectively. In short, the key emerging economies in Asia are leading the global recovery.

China's emergence as a global economic power has been among the most dramatic economic developments of recent decades. From 1980 to 2004, China's economy averaged a real GDP growth rate of 9.5 percent and became the world's sixth-largest economy. China's total share in world trade expanded from 1 percent in 1980 to almost 6 percent in 2003. By 2004, China had become the third-largest trading nation in dollar terms, behind the United States and Germany and just ahead of Japan.[5]

Emerging Europe The year 2007 marked the sixth consecutive year during which emerging Europe grew much faster than Western Europe, but growth in many countries was uneven. The global economic crisis that plagued this region finally came to an end in 2009, and most countries in the region are expected to see positive growth in 2010 and 2011.

Commonwealth of Independent States The growth in this region is expected to be 3.8 percent in 2010 and 4.0 percent in 2011. Strong growth is expected to continue in Azerbaijan and Armenia, whereas growth is projected to remain stable in Moldova, Tajikistan, and Uzbekistan.

After World War II, trade between the United States and the communist nations of Central and Eastern Europe was minimal. The United States maintained high tariff barriers on imports from most of these countries and also restricted their exports. However, since the disintegration of the Soviet Union and the collapse of communism, trade between the United States and Central and Eastern Europe has expanded substantially.

The countries that made the transition from communist to market economies quickly have recorded positive growth for several years—those that did not continue to struggle. Among the nations that have enjoyed several years of positive economic

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growth are the member countries of the Central European Free Trade Association: Hungary, the Czech Republic, Poland, Slovenia, and Slovakia.

U.S. exports to Central and Eastern Europe and Russia will increase, as will U.S. investment in these countries, as demand for capital goods and technology opens new markets for U.S. products. There already has been a substantial expansion in trade between the United States and the Czech Republic, Slovakia, Hungary, and Poland. Table 3.1 shows the growth rates from 2008 to 2011 for most regions of the world.

Exports and the U.S. Economy In 2008, U.S. exports supported more than 10.3 million full- and part-time jobs during a historic time, when exports as a percentage of GDP reached the highest levels since 1916. This new record, 12.7 percent of GDP, shows that U.S. businesses have great opportunities in the global marketplace. Even though the global economic crisis caused the number of jobs supported by exports to decline sharply to 8.5 million in 2009, globalization represents a huge opportunity for all countries—rich or poor. The 15-fold increase in trade volume over the past 55 years has been one of the most important factors in the rise of living standards around the world. During this time, exports have become increasingly important to the U.S. economy. Exports as a percentage of U.S. GDP have increased steadily since 1985, except in the 2001 and 2008 recessions. Our exports to developing and newly industrialized countries are on the rise. Table 3.2 shows the value of U.S. merchandise exports to, and imports from, each of the nation's ten major trading partners. Note that Canada and Mexico are our best partners for our exports; China and Canada, for imports.

Figure 3.3 shows the U.S. goods export and import shares in 2009. Major U.S. exports and imports are manufactured goods, agricultural products, and mineral fuels.

Table 3.1 Global Growth Remains Sluggish

Growth has been led by developing countries and emerging markets.

	Annual Percent Change			
	2008	2009	Projected 2010	Projected 2011
World	3.0	0.8	3.9	4.3
United States	0.4	−2.5	2.7	2.4
Euro area	0.6	−3.9	1.0	1.6
United Kingdom	0.5	−4.8	1.3	2.7
Japan	−1.2	−5.3	1.7	2.2
Canada	0.4	−2.6	2.6	3.6
Other advanced economies	1.7	−1.3	3.3	3.6
Newly industrialized Asian economies	1.7	−1.2	4.8	4.7
Developing countries and emerging markets	6.1	2.1	6.0	6.3
Africa	5.2	1.9	4.3	5.3
Developing Asia	7.9	6.5	8.4	8.4
Commonwealth of Independent States	5.5	−7.5	3.8	4.0
Middle East	5.3	2.2	4.5	4.8
Western Hemisphere	4.2	−2.3	3.7	3.8

Source: ***International Monetary Fund: World Economic Outlook*** **by International Monetary Fund. Copyright 2008 by International Monetary Fund. Reproduced with permission of International Monetary Fund via Copyright Clearance Center. http://www.imf.org/external/pubs/ft/weo/2010/update/01/index.htm (accessed April 19, 2010).**

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Table 3.2 Value of U.S. Merchandise Exports and Imports, 2009

Rank/Trading Partner	Exports ($ billions)	Rank/Trading Partner	Imports ($ billions)
1/Canada	204.7	1/China	296.4
2/Mexico	129.0	2/Canada	224.9
3/China	69.6	3/Mexico	176.5
4/Japan	51.2	4/Japan	95.9
5/United Kingdom	45.7	5/Germany	71.3
6/Germany	43.3	6/United Kingdom	47.5
7/Netherlands	32.3	7/South Korea	39.2
8/South Korea	28.6	8/France	34.0
9/France	26.5	9/Taiwan	28.4
10/Brazil	26.2	10/Venezuela	28.1

Source: U.S. Department of Commerce, International Trade Administration, http://www.census.gov/foreign-trade/statistics/highlights/top/top0912yr.html (accessed April 19, 2010).

4

Discuss international trade agreements and international economic organizations working to foster trade.

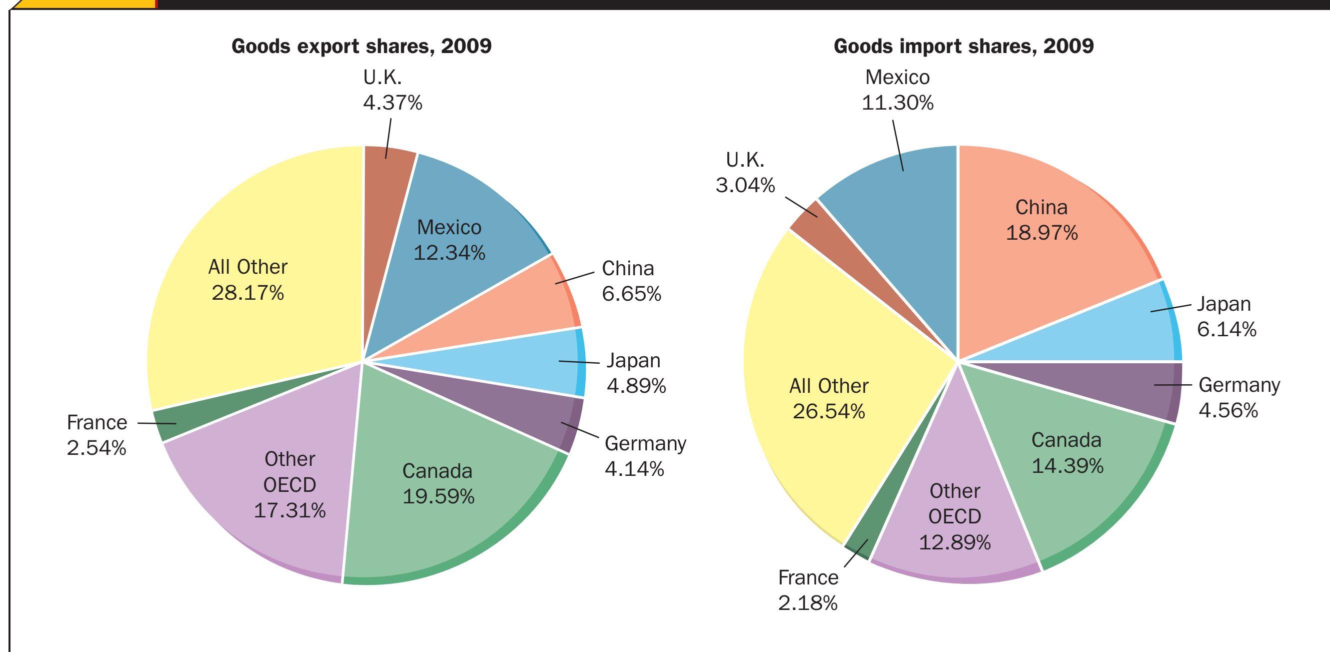
International Trade Agreements

The General Agreement on Tariffs and Trade and the World Trade Organization

At the end of World War II, the United States and 22 other nations organized the body that came to be known as GATT. The **General Agreement on Tariffs and Trade (GATT)** was an international organization of 153 nations dedicated to reducing or eliminating tariffs and other barriers to world trade. These 153 nations accounted for more than 97 percent of the world's merchandise trade (see Figure 3.4). GATT, headquartered in Geneva, Switzerland, provided a forum for tariff negotiations and a means for settling international trade disputes and problems. *Most-favored-nation status* (MFN) was the famous principle of GATT. It meant that each GATT member nation was to be treated equally by all contracting nations. Therefore, MFN ensured

General Agreement on Tariffs and Trade (GATT) an international organization of 153 nations dedicated to reducing or eliminating tariffs and other barriers to world trade

Figure 3.3 U.S. Goods Export and Import Shares in 2009



Source: Federal Reserve Bank of St. Louis, *National Economic Trends*, May 2010, 18.

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Figure 3.4 WTO Members Share in World Merchandise Trade, 2008

The 153 member nations account for more than 97 percent of the world's merchandise trade.

Source: http://www.wto.org (accessed on May 25, 2010).

that any tariff reductions or other trade concessions were extended automatically to all GATT members. From 1947 to 1994, the body sponsored eight rounds of negotiations to reduce trade restrictions. Three of the most fruitful were the Kennedy Round, the Tokyo Round, and the Uruguay Round.

The Kennedy Round (1964–1967) In 1962, the U.S. Congress passed the Trade Expansion Act. This law gave President John F. Kennedy the authority to negotiate reciprocal trade agreements that could reduce U.S. tariffs by as much as 50 percent. Armed with this authority, which was granted for a period of five years, President Kennedy called for a round of negotiations through GATT.

These negotiations, which began in 1964, have since become known as the Kennedy Round. They were aimed at reducing tariffs and other barriers to trade in both industrial and agricultural products. The participants succeeded in reducing tariffs on these products by an average of more than 35 percent. However, they were less successful in removing other types of trade barriers.

The Tokyo Round (1973–1979) In 1973, representatives of approximately 100 nations gathered in Tokyo for another round of GATT negotiations. The *Tokyo Round* was completed in 1979. The participants negotiated tariff cuts of 30 to 35 percent, which were to be implemented over an eight-year period. In addition, they were able to remove or ease such nontariff barriers as import quotas, unrealistic quality standards for imports, and unnecessary red tape in customs procedures.

The Uruguay Round (1986–1993) In 1986, the *Uruguay Round* was launched to extend trade liberalization and widen the GATT treaty to include textiles, agricultural products, business services, and intellectual-property rights.

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This most ambitious and comprehensive global commercial agreement in history concluded overall negotiations on December 15, 1993, with delegations on hand from 109 nations. The agreement included provisions to lower tariffs by greater than one-third, to reform trade in agricultural goods, to write new rules of trade for intellectual property and services, and to strengthen the dispute-settlement process. These reforms were expected to expand the world economy by an estimated $200 billion annually.

The Uruguay Round also created the **World Trade Organization (WTO)** on January 1, 1995. The WTO was established by GATT to oversee the provisions of the Uruguay Round and resolve any resulting trade disputes. Membership in the WTO obliges 153 member nations to observe GATT rules. The WTO has judicial powers to mediate among members disputing the new rules. It incorporates trade in goods, services, and ideas and exerts more binding authority than GATT.

The Doha Round (2001) On November 14, 2001, in Doha, Qatar, the WTO members agreed to further reduce trade barriers through multilateral trade negotiations over the next three years. This new round of negotiations focuses on industrial tariffs and nontariff barriers, agriculture, services, and easing trade rules. U.S. exporters of industrial and agricultural goods and services should have improved access to overseas markets. The Doha Round has set the stage for WTO members to take an important step toward significant new multilateral trade liberalization. It is a difficult task, but the rewards—lower tariffs, more choices for consumers, and further integration of developing countries into the world trading system—are sure to be worth the effort. Some experts suggest that U.S. exporters of industrial and agricultural goods and services should have improved access to overseas markets, whereas others disagree. Negotiations between the developed and developing countries continue.

World Trade and Global Economic Crisis

After the sharpest decline in more than 70 years, world trade was set to rebound in 2010 by growing at 9.5 percent, according to the WTO economists. According to WTO Director-General Pascal Lamy, "WTO rules and principles have assisted governments in keeping markets open and they now provide a platform for which trade can grow as the global economy improves. We see the light at the end of the tunnel and trade promises to be an important part of the recovery. But we must avoid derailing any economic revival through protectionism."[6]

Exports from developed economies are expected to rise by 7.5 percent in 2010, whereas exports from the rest of the world, including developing economies and the Commonwealth of Independent States, should increase by 11 percent as the world emerges from recession. This strong expansion will help recover some, but not all, of the loss in 2009, when the global economic crisis caused a 12.2 percent decline in the volume of global trade—the largest such decline since World War II.

International Economic Organizations Working to Foster Trade

The primary objective of the WTO is to remove barriers to trade on a worldwide basis. On a smaller scale, an **economic community** is an organization of nations formed to promote the free movement of resources and products among its members and to create common economic policies. A number of economic communities now exist.

- The European Union (EU), also known as the *European Economic Community* and the *Common Market*, was formed in 1957 by six countries—France, the Federal Republic of Germany, Italy, Belgium, the Netherlands, and Luxembourg. Its objective was freely conducted commerce among these nations and others that might later join. As shown in Figure 3.5, many more nations have joined the EU since then.

World Trade Organization (WTO) powerful successor to GATT that incorporates trade in goods, services, and ideas

economic community an organization of nations formed to promote the free movement of resources and products among its members and to create common economic policies

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Figure 3.5 The Evolving European Union

The Evolving European Union: The European Union is now an economic force, with a collective economy larger than that of the United States or Japan.

Source: http://europa.eu/abc/european_countries/index_en.htm (accessed May 25, 2010).

- On January 1, 2007, the 25 nations of the EU became the EU27 as Bulgaria and Romania became new members. The EU, with a population of nearly half a billion, is now an economic force with a collective economy larger than much of the United States or Japan.

In celebrating the EU's 50th anniversary in 2007, the president of the European Commission, Jose Manuel Durao Barraso, declared, "Let us first recognize 50 years of achievement. Peace, liberty, and prosperity, beyond the dreams of even the most optimistic founding fathers of Europe. In 1957, 15 of our 27 members were either under dictatorship or were not allowed to exist as independent countries. Now we are all prospering democracies. The EU of today is around 50 times more prosperous and with three times the population of the EU of 1957."

Since January 2002, 15 member nations of the EU have been participating in the new common currency, the euro. The euro is the single currency of the European Monetary Union nations. However, three EU members, Denmark, the United Kingdom, and Sweden, still keep their own currencies.

- A second community in Europe, the *European Economic Area* (EEA), became effective in January 1994. This pact consists of Iceland, Norway, Liechtenstein, and the 27 member nations of the EU. The EEA, encompassing an area inhabited by more than 500 million people, allows for the free movement of goods throughout all 30 countries.

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- The *North American Free Trade Agreement* (NAFTA) joined the United States with its first- and second-largest export trading partners, Canada and Mexico. Implementation of NAFTA on January 1, 1994, created a market of more than 454 million people. This market consists of Canada (population 34 million), the United States (309 million), and Mexico (111 million). According to the Office of the U.S. Trade Representative, after 14 years, NAFTA has achieved its core goals of expanding trade and investment between the United States, Canada, and Mexico. For example, from 1993 to 2007, trade among the NAFTA nations more than tripled, from $297 billion to $930 billion. Business investment in the Untied States has risen by 117 percent since 1993, compared to a 45 percent increase between 1979 and 1993. During the same period, the U.S. employment rose from 110.8 million people in 1993 to 137.6 million in 2007, an increase of 24 percent. The average unemployment rate was 5.1 percent in the period 1994 to 2007, compared with 7.1 percent during the period 1980 to 1993.[7]

  NAFTA is built on the Canadian Free Trade Agreement, signed by the United States and Canada in 1989, and on the substantial trade and investment reforms undertaken by Mexico since the mid-1980s. Initiated by the Mexican government, formal negotiations on NAFTA began in June 1991 among the three governments. The support of NAFTA by President Bill Clinton, past U.S. Presidents Ronald Reagan and Jimmy Carter, and Nobel Prize–winning economists provided the impetus for U.S. congressional ratification of NAFTA in November 1993. NAFTA will gradually eliminate all tariffs on goods produced and traded among Canada, Mexico, and the United States to provide for a totally free-trade area by 2009. Chile is expected to become the fourth member of NAFTA, but political forces may delay its entry into the agreement for several years.
- The *Central American Free Trade Agreement* (CAFTA) was created in 2003 by the United States and four Central American countries—El Salvador, Guatemala, Honduras, and Nicaragua. The CAFTA became CAFTA-DR when the Dominican Republic joined the group in 2007. On January 1, 2009, Costa Rica joined CAFTA-DR as the sixth member. CAFTA-DR creates the third-largest U.S. export market in Latin America, behind only Mexico and Brazil. The United States exported $22.4 billion in goods to the five Central American countries and the Dominican Republic in 2007. U.S. exports to the CAFTA-DR countries increased by 14.4 percent in 2008.[8]
- The *Association of Southeast Asian Nations*, with headquarters in Jakarta, Indonesia, was established in 1967 to promote political, economic, and social cooperation among its seven member countries: Indonesia, Malaysia, the Philippines, Singapore, Thailand, Brunei, and Vietnam. With the three new members, Cambodia, Laos, and Myanmar, this region is already our fifth-largest trading partner. The ten-member region, with a population of 592 million, has $1.5 trillion in GDP and accounts for more than $169 million worth of trade with the United States.[9]
- The *Pacific Rim,* referring to countries and economies bordering the Pacific Ocean, is an informal, flexible term generally regarded as a reference to East Asia, Canada, and the United States. At a minimum, the Pacific Rim includes Canada, Japan, China, Taiwan, and the United States.
- The *Commonwealth of Independent States* was established in December 1991 by the newly independent states as an association of 11 republics of the former Soviet Union.
- The *Caribbean Basin Initiative* (CBI) is an inter-American program led by the United States to give economic assistance and trade preferences to the Caribbean and Central American countries. CBI provides duty-free access to the U.S. market for most products from the region and promotes private-sector development in member nations.

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- The *Common Market of the Southern Cone* (MERCOSUR) was established in 1991 under the Treaty of Asuncion to unite Argentina, Brazil, Paraguay, and Uruguay as a free-trade alliance; Colombia, Ecuador, Peru, Bolivia, and Chile joined later as associates. The alliance represents more than 267 million consumers—67 percent of South America's population, making it the third-largest trading block behind NAFTA and the EU. Like NAFTA, MERCOSUR promotes "the free circulation of goods, services and production factors among the countries" and established a common external tariff and commercial policy.
- The *Organization of Petroleum Exporting Countries* was founded in 1960 in response to reductions in the prices that oil companies were willing to pay for crude oil. The organization was conceived as a collective bargaining unit to provide oil-producing nations with some control over oil prices.
- The *Organization for Economic Cooperation and Development* (OECD) is a group of 30 industrialized market-economy countries of North America, Europe, the Far East, and the South Pacific. OECD, headquartered in Paris, was established in 1961 to promote economic development and international trade.

Celebrating the 18th anniversary. The MERCOSUR alliance represents more than 267 million consumers—67 percent of South America's population, making it the third-largest trading block. Here, Paraguayan President Fernando Lugo speaks during a ceremony celebrating the 18th anniversary of the creation of the MERCOSUR trade block.

© JORGE ADORNO/Reuters /Landov

5

Define the methods by which a firm can organize for and enter into international markets.

Methods of Entering International Business

A firm that has decided to enter international markets can do so in several ways. We will discuss several different methods. These different approaches require varying degrees of involvement in international business. Typically, a firm begins its international operations at the simplest level. Then, depending on its goals, it may progress to higher levels of involvement.

Licensing

Licensing is a contractual agreement in which one firm permits another to produce and market its product and use its brand name in return for a royalty or other compensation. For example, Yoplait yogurt is a French yogurt licensed for production in the United States. The Yoplait brand maintains an appealing French image, and in return, the U.S. producer pays the French firm a percentage of its income from sales of the product.

Licensing is especially advantageous for small manufacturers wanting to launch a well-known domestic brand internationally. For example, all Spalding sporting products are licensed worldwide. The licensor, the Questor Corporation, owns the Spalding name but produces no goods itself. Licensing thus provides a simple method for expanding into a foreign market with virtually no investment. On the other hand, if the licensee does not maintain the licensor's product standards, the product's image may be damaged. Another possible disadvantage is that a licensing arrangement may not provide the original producer with any foreign marketing experience.

licensing a contractual agreement in which one firm permits another to produce and market its product and use its brand name in return for a royalty or other compensation

Exporting

A firm also may manufacture its products in its home country and export them for sale in foreign markets. As with licensing, exporting can be a relatively low-risk method of entering foreign markets. Unlike licensing, however, it is not a simple method; it opens up several levels of involvement to the exporting firm.

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Going for SUCCESS

LEGO Builds on Licensing for Global Growth

Over the past 15 years, Luke Skywalker, Batman, and Spider-Man have all helped fuel the global growth of Denmark's LEGO Group. Founded in 1932 to market wooden toys, LEGO patented its now iconic interlocking plastic bricks in 1958. The brick system became an instant sensation.

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Decades later, with high-tech toys such as robots and video games crowding store shelves, LEGO executives began looking for a way to connect the timeless appeal of their bricks to pop-culture trends worldwide. The answer: licensing. The first license they arranged was with Lucasfilm, covering popular characters such as Luke Skywalker and R2-D2, as well as spaceships and weapons in LEGO form, based on the blockbuster Star Wars films. These licensed products became so popular in so many countries that LEGO pursued additional licenses.

Today the company offers all kinds of licensed products featuring fictional favorites, such as Harry Potter, Indiana Jones, Batman, Spider-Man, and SpongeBob SquarePants. LEGO's license with Walt Disney allows it to market plastic blocks and figures based on Toy Story, Cars, and Prince of Persia. Even as many competitors struggled during the recent economic turmoil, LEGO has prospered because more than half of its global sales come from products linked to such brand licenses.

Sources: Lauren McKay, "Where Does Innovation Come From?" *CRM Magazine*, January 2010, 24ff; "Toymaker Grows by Listening to Customers," *Advertising Age*, November 9, 2009, 15; "LEGO: Always Listening," *Advertising Age*, October 19, 2009, 4; "Disney, LEGO Strike Licensing Deal," *Triangle Business Journal*, February 16, 2009, http://triangle.bizjournals.com; LEGO Web site and company profile, http://www.lego.com.

At the most basic level, the exporting firm may sell its products outright to an *export–import merchant*, which is essentially a merchant wholesaler. The merchant assumes all the risks of product ownership, distribution, and sale. It may even purchase the goods in the producer's home country and assume responsibility for exporting the goods. An important and practical issue for domestic firms dealing with foreign customers is securing payment. This is a two-sided issue that reflects the mutual concern rightly felt by both parties to the trade deal: The exporter would like to be paid before shipping the merchandise, whereas the importer obviously would prefer to know that it has received the shipment before releasing any funds. Neither side wants to take the risk of fulfilling its part of the deal only to discover later that the other side has not. The result would lead to legal costs and complex, lengthy dealings that would waste everyone's resources. This mutual level of mistrust, in fact, makes good business sense and has been around since the beginning of trade centuries ago. The solution then was the same as it still is today—for both parties to use a mutually trusted go-between who can ensure that the payment is held until the merchandise is in fact delivered according to the terms of the trade contract. The go-between representatives employed by the importer and exporter are still, as they were in the past, the local domestic banks involved in international business.

letter of credit issued by a bank on request of an importer stating that the bank will pay an amount of money to a stated beneficiary

Exporting to international markets. American companies may manufacture their products in the United States and export them for sale in foreign markets. Exporting can be a relatively low-risk method of entering foreign markets.

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Here is a simplified version of how it works. After signing contracts detailing the merchandise sold and terms for its delivery, an importer will ask its local bank to issue a **letter of credit** for the amount of money needed to pay for the merchandise. The letter of credit is

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issued "in favor of the exporter," meaning that the funds are tied specifically to the trade contract involved. The importer's bank forwards the letter of credit to the exporter's bank, which also normally deals in international transactions. The exporter's bank then notifies the exporter that a letter of credit has been received in its name, and the exporter can go ahead with the shipment. The carrier transporting the merchandise provides the exporter with evidence of the shipment in a document called a **bill of lading**. The exporter signs over title to the merchandise (now in transit) to its bank by delivering signed copies of the bill of lading and the letter of credit.

In exchange, the exporter issues a **draft** from the bank, which orders the importer's bank to pay for the merchandise. The draft, bill of lading, and letter of credit are sent from the exporter's bank to the importer's bank. Acceptance by the importer's bank leads to return of the draft and its sale by the exporter to its bank, meaning that the exporter receives cash and the bank assumes the risk of collecting the funds from the foreign bank. The importer is obliged to pay its bank on delivery of the merchandise, and the deal is complete.

In most cases, the letter of credit is part of a lending arrangement between the importer and its bank. Of course, both banks earn fees for issuing letters of credit and drafts and for handling the import–export services for their clients. Furthermore, the process incorporates the fact that both importer and exporter will have different local currencies and might even negotiate their trade in a third currency. The banks look after all the necessary exchanges. For example, the vast majority of international business is negotiated in U.S. dollars, even though the trade may be between countries other than the United States. Thus, although the importer may end up paying for the merchandise in its local currency and the exporter may receive payment in another local currency, the banks involved will exchange all necessary foreign funds in order to allow the deal to take place.

bill of lading document issued by a transport carrier to an exporter to prove that merchandise has been shipped

draft issued by the exporter's bank, ordering the importer's bank to pay for the merchandise, thus guaranteeing payment once accepted by the importer's bank

Alternatively, the exporting firm may ship its products to an *export–import agent*, which arranges the sale of the products to foreign intermediaries for a commission or fee. The agent is an independent firm—like other agents—that sells and may perform other marketing functions for the exporter. The exporter, however, retains title to the products during shipment and until they are sold.

An exporting firm also may establish its own *sales offices*, or *branches*, in foreign countries. These installations are international extensions of the firm's distribution system. They represent a deeper involvement in international business than the other exporting techniques we have discussed—and thus they carry a greater risk. The exporting firm maintains control over sales, and it gains both experience in and knowledge of foreign markets. Eventually, the firm also may develop its own sales force to operate in conjunction with foreign sales offices.

Joint Ventures

A *joint venture* is a partnership formed to achieve a specific goal or to operate for a specific period of time. A joint venture with an established firm in a foreign country provides immediate market knowledge and access, reduced risk, and control over product attributes. However, joint-venture agreements established across national borders can become extremely complex. As a result, joint-venture agreements generally require a very high level of commitment from all the parties involved.

A joint venture may be used to produce and market an existing product in a foreign nation or to develop an entirely new product. Recently, for example, Archer Daniels Midland Company (ADM), one of the world's leading food processors, entered into a joint venture with

GE venturing into a joint venture. In 2010, GE Oil and Gas and Triveni Engineering & Industries Limited have signed a joint venture agreement to design, manufacture, supply, sell, and service advanced technology steam turbines in India. The joint venture, which will benefit from a full technology transfer and ongoing R&D support from GE, will use Triveni's Bangalore facility for turbine manufacturing.

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Gruma SA, Mexico's largest corn flour and tortilla company. Besides a 22 percent stake in Gruma, ADM also received stakes in other joint ventures operated by Gruma. One of them will combine both companies' U.S. corn flour operations, which account for about 25 percent of the U.S. market. ADM also has a 40 percent stake in a Mexican wheat flour mill. ADM's joint venture increased its participation in the growing Mexican economy, where ADM already produces corn syrup, fructose, starch, and wheat flour.

Totally Owned Facilities

At a still deeper level of involvement in international business, a firm may develop *totally owned facilities*, that is, its own production and marketing facilities in one or more foreign nations. This *direct investment* provides complete control over operations, but it carries a greater risk than the joint venture. The firm is really establishing a subsidiary in a foreign country. Most firms do so only after they have acquired some knowledge of the host country's markets.

Direct investment may take either of two forms. In the first, the firm builds or purchases manufacturing and other facilities in the foreign country. It uses these facilities to produce its own established products and to market them in that country and perhaps in neighboring countries. Firms such as General Motors, Union Carbide, and Colgate-Palmolive are multinational companies with worldwide manufacturing facilities. Colgate-Palmolive factories are becoming *Eurofactories*, supplying neighboring countries as well as their own local markets.

A second form of direct investment in international business is the purchase of an existing firm in a foreign country under an arrangement that allows it to operate independently of the parent company. When Sony Corporation (a Japanese firm) decided to enter the motion picture business in the United States, it chose to purchase Columbia Pictures Entertainment, Inc., rather than start a new motion picture studio from scratch.

Strategic Alliances

A **strategic alliance**, the newest form of international business structure, is a partnership formed to create competitive advantage on a worldwide basis. Strategic alliances are very similar to joint ventures. The number of strategic alliances is growing at an estimated rate of about 20 percent per year. In fact, in the automobile and computer industries, strategic alliances are becoming the predominant means of competing. International competition is so fierce and the costs of competing on a global basis are so high that few firms have all the resources needed to do it alone. Thus, individual firms that lack the internal resources essential for international success may seek to collaborate with other companies.

An example of such an alliance is the New United Motor Manufacturing, Inc. (NUMMI), formed by Toyota and General Motors to make automobiles of both firms. This enterprise united the quality engineering of Japanese cars with the marketing expertise and market access of General Motors.[10]

Trading Companies

A **trading company** provides a link between buyers and sellers in different countries. A trading company, as its name implies, is not involved in manufacturing or owning assets related to manufacturing. It buys products in one country at the lowest price consistent with quality and sells to buyers in another country. An important function of trading companies is taking title to products and performing all the activities necessary to move the products from the domestic country to a foreign country. For example, large grain-trading companies operating out of home offices both in the United States and overseas control a major portion of the world's trade in basic food commodities. These trading companies sell homogeneous

strategic alliance a partnership formed to create competitive advantage on a worldwide basis

trading company provides a link between buyers and sellers in different countries

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agricultural commodities that can be stored and moved rapidly in response to market conditions.

Countertrade

In the early 1990s, many developing nations had major restrictions on converting domestic currency into foreign currency. Therefore, exporters had to resort to barter agreements with importers. **Countertrade** is essentially an international barter transaction in which goods and services are exchanged for different goods and services. Examples include Saudi Arabia's purchase of ten 747 jets from Boeing with payment in crude oil and Philip Morris' sale of cigarettes to Russia in return for chemicals used to make fertilizers.

Multinational Firms

A **multinational enterprise** is a firm that operates on a worldwide scale without ties to any specific nation or region. The multinational firm represents the highest level of involvement in international business. It is equally "at home" in most countries of the world. In fact, as far as the operations of the multinational enterprise are concerned, national boundaries exist only on maps. It is, however, organized under the laws of its home country.

Table 3.3 shows the ten largest foreign and U.S. public multinational companies; the ranking is based on a composite score reflecting each company's best three out of four rankings for sales, profits, assets, and market value. Table 3.4 describes steps in entering international markets.

Career SUCCESS

Volunteer Abroad to Prepare to Work Abroad

If your career plans include getting a job abroad, consider doing volunteer work in another country before you graduate. By volunteering abroad, you can feel good about helping people and communities in need while you polish your communication skills and add to your résumé.

Although you will not be paid, you will have countless opportunities to learn about the world and yourself as you confront unfamiliar situations and new challenges. Later, when you are in the market for a full-time job, even a brief international volunteer stint is likely to make your employment application stand out and demonstrate your interest in working overseas.

Whether you volunteer in your chosen field or work for a charity or cause you believe in, you will return with new insights and ideas. Jonathan King was a biology major at West Virginia University when he went to Africa through Amizade, a not-for-profit organization that tackles projects such as building community clinics and new schools. Despite the initial culture shock, King says he benefited from the experience of volunteering in hospitals and orphanages—and he plans to go back.

In addition to Amizade, other groups that offer international volunteer programs for college students include Habitat for Humanity, Global Volunteers, and EarthWatch Institute. Check on your campus for more information about these and other opportunities to make a difference while preparing for future work abroad.

Sources: "Where to Find a Voluntourism Program," *Washington Post*, December 13, 2009, http://www.washingtonpost.com; Chloe White Kennedy, "Collegians Help Pay for School Costs in Ghana," *Knoxville News (TN)*, November 26, 2009, http://www.knoxnews.com; Morgan Young, "A Real Culture Shock," *The Daily Athenaeum (West Virginia University)*, September 3, 2009, http://www.thedaonline.com/news/a-real-culture-shock-1.349936.

Table 3.3 The Ten Largest Foreign and U.S. Multinational Corporations

2009 Rank	Company	Business	Country	Revenue ($ millions)
1	Royal Dutch/Shell Group	Energy	Netherlands/ United Kingdom	458,361
2	ExxonMobil	Energy	United States	442,851
3	Walmart Stores	General merchandiser	United States	405,607
4	BP	Energy	United Kingdom	367,053
5	Chevron	Energy	United States	263,159
6	Total	Energy	France	234,674
7	Conoco Phillips	Energy	United States	230,764
8	ING Group	Financial services	Netherlands	226,577
9	Sinopec	Energy	China	207,815
10	Toyota Motor	Automobiles	Japan	204,352

Source: http://money.cnn.com/magazines/fortune/global500/2009/snapshots/6752.html (accessed May 23, 2010).

countertrade an international barter transaction

multinational enterprise a firm that operates on a worldwide scale without ties to any specific nation or region

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Table 3.4 Steps in Entering International Markets

Step	Activity	Marketing Tasks
1	Identify exportable products.	Identify key selling features. Identify needs that they satisfy. Identify the selling constraints that are imposed.
2	Identify key foreign markets for the products.	Determine who the customers are. Pinpoint what and when they will buy. Do market research. Establish priority, or "target," countries.
3	Analyze how to sell in each priority market (methods will be affected by product characteristics and unique features of country/market).	Locate available government and private-sector resources. Determine service and backup sales requirements.
4	Set export prices and payment terms, methods, and techniques.	Establish methods of export pricing. Establish sales terms, quotations, invoices, and conditions of sale. Determine methods of international payments, secured and unsecured.
5	Estimate resource requirements and returns.	Estimate financial requirements. Estimate human resources requirements (full- or part-time export department or operation?). Estimate plant production capacity. Determine necessary product adaptations.
6	Establish overseas distribution network.	Determine distribution agreement and other key marketing decisions (price, repair policies, returns, territory, performance, and termination). Know your customer (use U.S. Department of Commerce international marketing services).
7	Determine shipping, traffic, and documentation procedures and requirements.	Determine methods of shipment (air or ocean freight, truck, rail). Finalize containerization. Obtain validated export license. Follow export-administration documentation procedures.
8	Promote, sell, and be paid.	Use international media, communications, advertising, trade shows, and exhibitions. Determine the need for overseas travel (when, where, and how often?). Initiate customer follow-up procedures.
9	Continuously analyze current marketing, economic, and political situations.	Recognize changing factors influencing marketing strategies. Constantly re-evaluate.

Source: U.S. Department of Commerce, International Trade Administration, Washington, DC.

According to the chairman of the board of Dow Chemical Company, a multinational firm of U.S. origin, "The emergence of a world economy and of the multinational corporation has been accomplished hand in hand." He sees multinational enterprises moving toward what he calls the "anational company," a firm that has no nationality but belongs to all countries. In recognition of this movement, there already have been international conferences devoted to the question of how such enterprises would be controlled.

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Table 3.5	U.S. Government Export Assistance Programs	
1	U.S. Export Assistance Centers, http://www.sba.gov/oit/export/useac.html	Provides assistance in export marketing and trade finance
2	International Trade Administration, http://www.ita.doc.gov/	Offers assistance and information to exporters through its domestic and overseas commercial officers
3	U.S. and Foreign Commercial Services, http://www.export.gov/	Helps U.S. firms compete more effectively in the global marketplace and provides information on foreign markets
4	Advocacy Center, http://www.ita.doc.gov/advocacy	Facilitates advocacy to assist U.S. firms competing for major projects and procurements worldwide
5	Trade Information Center, http://www.ita.doc.gov/td/tic/	Provides U.S. companies information on federal programs and activities that support U.S. exports
6	STAT-USA/Internet, http://www.stat-usa.gov/	Offers a comprehensive collection of business, economic, and trade information on the Web
7	Small Business Administration, http://www.sba.gov/oit/	Publishes many helpful guides to assist small- and medium-sized companies
8	National Trade Data Bank, http://www.stat-usa.gov/tradtest.nsf	Provides international economic and export-promotion information supplied by more than 20 U.S. agencies

Sources of Export Assistance

6

Describe the various sources of export assistance.

In September 1993, President Bill Clinton announced the *National Export Strategy* (NES) to revitalize U.S. exports. Under the NES, the *Trade Promotion Coordinating Committee* (TPCC) assists U.S. firms in developing export-promotion programs. The export services and programs of the 19 TPCC agencies can help American firms to compete in foreign markets and create new jobs in the United States. Table 3.5 provides an overview of selected export assistance programs.

These and other sources of export information enhance the business opportunities of U.S. firms seeking to enter expanding foreign markets. Another vital energy factor is financing.

Financing International Business

7

Identify the institutions that help firms and nations finance international business.

International trade compounds the concerns of financial managers. Currency exchange rates, tariffs and foreign exchange controls, and the tax structures of host nations all affect international operations and the flow of cash. In addition, financial managers must be concerned both with the financing of their international operations and with the means available to their customers to finance purchases.

Fortunately, along with business in general, a number of large banks have become international in scope. Many have established branches in major cities around the world. Thus, like firms in other industries, they are able to provide their services where and when they are needed. In addition, financial assistance is available from U.S. government and international sources.

Several of today's international financial organizations were founded many years ago to facilitate free trade and the exchange of currencies among nations. Some, such as the Inter-American Development Bank, are supported internationally and focus on developing countries. Others, such as the Export-Import Bank, are operated by one country but provide international financing.

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Sustaining the Planet

Selling Eco-Friendly Goods, Services, and Technologies

Since 1994, the Export-Import Bank's Environmental Export Financing Program has been promoting sustainability by helping U.S. businesses obtain the funding they need to sell their eco-friendly goods, services, and technologies to overseas buyers around the world. Take a look: http://www.exim.gov/products/policies/environment/index.cfm.

© Ex-Im Bank's Web site at www.exim.gov

The Export-Import Bank of the United States

The **Export-Import Bank of the United States**, created in 1934, is an independent agency of the U.S. government whose function is to assist in financing the exports of American firms. *Ex-Im Bank*, as it is commonly called, extends and guarantees credit to overseas buyers of American goods and services and guarantees short-term financing for exports. It also cooperates with commercial banks in helping American exporters to offer credit to their overseas customers.

According to Fred P. Hochberg, chairman and president of Ex-Im Bank, "Working with private lenders we are helping U.S. exporters put Americans to work producing the high quality goods and services that foreign buyers prefer. As part of President Obama's National Export Initiative, Ex-Im Bank's export financing is contributing to the goal of doubling of U.S. exports within the next five years."

Multilateral Development Banks

A **multilateral development bank (MDB)** is an internationally supported bank that provides loans to developing countries to help them grow. The most familiar is the World Bank, which operates worldwide. Established in 1944 and headquartered in Washington, DC, the bank provides low-interest loans, interest-free credits, and grants to developing countries. In 2009, the World Bank provided $46.9 billion for 303 projects in developing countries. Its more than 1,800 projects include providing credit in Bosnia and Herzegovina, raising AIDS-prevention awareness in Guinea, supporting the education of girls in Bangladesh, improving health care delivery in Mexico, and helping India rebuild Gujarat after a devastating earthquake.[11] Four other MDBs operate primarily in Central and South America, Asia, Africa, and Eastern and Central Europe. All five are supported by the industrialized nations, including the United States.

The *Inter-American Development Bank* (IDB), the oldest and largest regional bank, was created in 1959 by 19 Latin American countries and the United States. The bank, which is headquartered in Washington, DC, makes loans and provides technical advice and assistance to countries. Today, the IDB is owned by 48 member states.

With 67 member nations, the *Asian Development Bank* (ADB), created in 1966 and headquartered in the Philippines, promotes economic and social progress in Asian and Pacific regions. The U.S. government is the second-largest contributor to the ADB's capital, after Japan.

The *African Development Bank* (AFDB), also known as *Banque Africaines de Development,* was established in 1964 with headquarters in Abidjan, Ivory Coast. Its members include 53 African and 24 non-African countries from the Americas, Europe, and Asia. The AFDB's goal is to foster the economic and social development of its African members. The bank pursues this goal through loans, research, technical assistance, and the development of trade programs.

Established in 1991 to encourage reconstruction and development in the Eastern and Central European countries, the London-based *European Bank*

Export-Import Bank of the United States an independent agency of the U.S. government whose function is to assist in financing the exports of American firms

multilateral development bank (MDB) an internationally supported bank that provides loans to developing countries to help them grow

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Mission possible. The Export-Import Bank of the United States (Ex-Im Bank) is the official export credit agency of the United States. Ex-Im Bank's mission is to assist in financing U.S. goods and services to international markets. With more than 70 years of experience, Ex-Im Bank has supported more than $400 billion of U.S. exports, primarily to developing markets worldwide.

© Export-Import Bank of the United States (www.exim.gov)

for Reconstruction and Development is owned by 61 countries and 2 intergovernmental institutions. Its loans are geared toward developing market-oriented economies and promoting private enterprise.

The International Monetary Fund

The **International Monetary Fund (IMF)** is an international bank with 186 member nations that makes short-term loans to developing countries experiencing balance-of-payment deficits. This financing is contributed by member nations, and it must be repaid with interest. Loans are provided primarily to fund international trade. Created in 1945 and headquartered in Washington, DC, the bank's main goals are to:

- promote international monetary cooperation,
- facilitate the expansion and balanced growth of international trade,
- promote exchange rate stability,
- assist in establishing a multilateral system of payments, and
- make resources available to members experiencing balance-of-payment difficulties.

International Monetary Fund (IMF) an international bank with 186 member nations that makes short-term loans to developing countries experiencing balance-of-payment deficits

return to inside business

Samsung

From its modest roots as a food exporter, Samsung Electronics has grown into a world-class powerhouse that exports more than $50 billion worth of products every year. During the past decade, the company has increased total revenue fivefold, and CEO Lee Yoon-Woo recently set the ambitious goal of achieving $400 billion in annual sales by 2020.

Meanwhile, the ever-higher buying power of consumers in South Korea is attracting competitors from abroad, adding to the competitive pressure on Samsung Electronics in its home country. When Apple began exporting iPhones to South Korea, Samsung Electronics fought back by reducing the price of its touch-screen phones—which, in turn, cut into its profit margins. Can the company maintain its competitive momentum and continue as a shining star in the crowded global marketplace?

Questions

1. How much should Samsung Electronics rely on joint ventures and strategic alliances as it seeks to reach $400 billion in revenue by 2020?
2. According to the case, is Samsung Electronics a multinational enterprise? Explain your answer.

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SUMMARY

Summary

1 Explain the economic basis for international business.

International business encompasses all business activities that involve exchanges across national boundaries. International trade is based on specialization, whereby each country produces the goods and services that it can produce more efficiently than any other goods and services. A nation is said to have a comparative advantage relative to these goods. International trade develops when each nation trades its surplus products for those in short supply.

A nation's balance of trade is the difference between the value of its exports and the value of its imports. Its balance of payments is the difference between the flow of money into and out of the nation. Generally, a negative balance of trade is considered unfavorable.

2 Discuss the restrictions nations place on international trade, the objectives of these restrictions, and their results.

Despite the benefits of world trade, nations tend to use tariffs and nontariff barriers (import quotas, embargoes, and other restrictions) to limit trade. These restrictions typically are justified as being needed to protect a nation's economy, industries, citizens, or security. They can result in the loss of jobs, higher prices, fewer choices in the marketplace, and the misallocation of resources.

3 Outline the extent of international business and the world economic outlook for trade.

World trade is generally increasing. Trade between the United States and other nations is increasing in dollar value but decreasing in terms of our share of the world market. Exports as a percentage of U.S. GDP have increased steadily since 1985, except in the 2001 and 2008 recessions.

4 Discuss international trade agreements and international economic organizations working to foster trade.

The General Agreement on Tariffs and Trade (GATT) was formed to dismantle trade barriers and provide an environment in which international business can grow. Today, the World Trade Organization (WTO) and various economic communities carry on this mission. These world economic communities include the European Union, the NAFTA, the CAFTA, the Association of Southeast Asian Nations, the Pacific Rim, the Commonwealth of Independent States, the Caribbean Basin Initiative, the Common Market of the Southern Cone, the Organization of Petroleum Exporting Countries, and the Organization for Economic Cooperation and Development.

5 Define the methods by which a firm can organize for and enter into international markets.

A firm can enter international markets in several ways. It may license a foreign firm to produce and market its products. It may export its products and sell them through foreign intermediaries or its own sales organization abroad, or it may sell its exports outright to an export–import merchant. It may enter into a joint venture with a foreign firm. It may establish its own foreign subsidiaries, or it may develop into a multinational enterprise.

Generally, each of these methods represents an increasingly deeper level of involvement in international business, with licensing being the simplest and the development of a multinational corporation the most involved.

6 Describe the various sources of export assistance.

Many government and international agencies provide export assistance to U.S. and foreign firms. The export services and programs of the 19 agencies of the U.S. Trade Promotion Coordinating Committee (TPCC) can help U.S. firms to compete in foreign markets and create new jobs in the United States. Sources of export assistance include U.S. Export Assistance Centers, the International Trade Administration, U.S. and Foreign Commercial Services, Export Legal Assistance Network, Advocacy Center, National Trade Data Bank, and other government and international agencies.

7 Identify the institutions that help firms and nations finance international business.

The financing of international trade is more complex than that of domestic trade. Institutions such as the Ex-Im Bank and the International Monetary Fund have been established to provide financing and ultimately to increase world trade for American and international firms.

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Key Terms

You should now be able to define and give an example relevant to each of the following terms:

international business (73)
absolute advantage (73)
comparative advantage (73)
exporting (74)
importing (75)
balance of trade (75)
trade deficit (75)
balance of payments (76)
import duty (tariff) (76)
dumping (77)
nontariff barrier (77)
import quota (77)
embargo (77)
foreign-exchange control (77)
currency devaluation (77)
General Agreement on Tariffs and Trade (GATT) (82)
World Trade Organization (WTO) (84)
economic community (84)
licensing (87)
letter of credit (88)
bill of lading (89)
draft (89)
strategic alliance (90)
trading company (90)
countertrade (91)
multinational enterprise (91)
Export-Import Bank of the United States (94)
multilateral development bank (MDB) (94)
International Monetary Fund (IMF) (95)

Review Questions

1. Why do firms engage in international trade?
2. What is the difference between an absolute and a comparative advantage in international trade? How are both types of advantages related to the concept of specialization?
3. What is a favorable balance of trade? In what way is it "favorable"?
4. List and briefly describe the principal restrictions that may be applied to a nation's imports.
5. What reasons are generally given for imposing trade restrictions?
6. What are the general effects of import restrictions on trade?
7. Define and describe the major objectives of the WTO and the international economic communities.
8. Which nations are the principal trading partners of the United States? What are the major U.S. imports and exports?
9. The methods of engaging in international business may be categorized as either direct or indirect. How would you classify each of the methods described in this chapter? Why?
10. In what ways is a multinational enterprise different from a large corporation that does business in several countries?
11. List some key sources of export assistance. How can these sources be useful to small business firms?
12. In what ways do the Ex-Im Bank, multilateral development banks, and the IMF enhance international trade?

Discussion Questions

1. The United States restricts imports but, at the same time, supports the WTO and international banks whose objective is to enhance world trade. As a member of Congress, how would you justify this contradiction to your constituents?
2. What effects might the devaluation of a nation's currency have on its business firms, its consumers, and the debts it owes to other nations?
3. Should imports to the United States be curtailed by, say, 20 percent to eliminate our trade deficit? What might happen if this were done?
4. When should a firm consider expanding from strictly domestic trade to international trade? When should it consider becoming further involved in international trade? What factors might affect the firm's decisions in each case?
5. How can a firm obtain the expertise needed to produce and market its products in, for example, the EU?

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Video Case 3.1

Evo: Creatively Exceeding Customer Expectations Here and Abroad

Evo is proof that a company does not have to be large or operate worldwide in order to run a successful global business. Based in Seattle, Evo is an online and brick-and-mortar retailer of skiing, wakeboarding, skateboarding, and snowboarding equipment and clothing that recently reached $10 million in annual sales. It employs about 70 people and has been growing more than 70 percent a year since moving beyond founder Bryce Phillips' apartment eight years ago.

Evo now maintains a 40,000-square-foot distribution center and a busy Seattle store, along with a highly successful retail Web site, EvoGear.com. It is through the Web site that Evo started the global side of its operations, serving customers as far away as Bahrain, Turkey, Bali, Europe, and Australia and New Zealand. Because taxes, duties, exchange rates, and shipping requirements are so complex, for now customers in countries other than the United States and Canada must call the company's customer-service line to personally place their orders and arrange shipping and payment individually. Although for the present these customers account for a very small percentage of Evo's annual orders (5 percent including Canada), the company's managers hope that the growth of e-commerce will eventually ease order-handling and payment procedures enough to let this side of the business grow.

Another factor that might continue to limit Evo's international growth in the meantime is the business practices of Evo's suppliers. Most of these equipment manufacturers want to protect their own brands, so they restrict the amount of their products that any one retailer can sell to avoid saturating markets and to keep competition fair. Thus, Evo sometimes has to turn down requests for particular products, though the company hopes that this problem too will some day be overcome. For now the firm is able to keep its customer-service lines open for less than 24 hours a day and still remain accessible to most of its international callers.

The firm does not have plans to open any overseas operations because its shipping partners are already located everywhere that Evo needs assistance abroad. Most of the company's overseas suppliers have offices or representatives in the United States, so Evo team members usually travel only within the country for trade shows and the like. One exception is founder Bryce Phillips himself.

Evo has recently begun offering extreme skiing, snowboarding, and surfing expeditions to its customers through a new operation called EvoTrip. By outsourcing the logistics of these trips to a separate international travel company called JustFares.com, Evo is able to focus on choosing destinations like Japan, Indonesia, Switzerland, and South America, many of which Phillips has visited and enjoyed, and arranging for professional athletes to accompany each group. Each of these trips, Phillips feels, is an opportunity for Evo's "ambassadors" to seamlessly spread the word about the company to potential new customers in every country they visit.

Despite management's conviction that its domestic business probably brings a better return on investment for now than its global operations, Evo can still proudly call itself a multinational firm.[12]

Questions

1. Do you think Evo's decision not to set up any physical operations overseas is a good one? Why or why not?
2. What political and economic challenges could EvoTrip encounter in other countries?
3. Would you recommend that Evo expand the international side of its business? If so, how, and if not, why not?

Case 3.2

Global Profits Are a Menu Mainstay at McDonald's

Few U.S. businesses are as international as McDonald's, the Illinois-based fast-food giant that began as an all-American hamburger place. With $22 billion in annual revenue, McDonald's now rings the world with 32,400 restaurants and serves 60 million customers every day. Although the United States accounts for 35 percent of McDonald's global revenue, Europe accounts for 41 percent and the Asia/Pacific, Middle East, and Africa regions account for 19 percent.

Hamburgers are, of course, the main attraction in many McDonald's restaurants: worldwide, the company sells more than four million burgers every day. However, one of McDonald's key strengths is its ability to adapt to local tastes. In Japan, McDonald's sells Cheese Katsu sandwiches, featuring fried pork and cheese. In the Middle East, it sells McArabia pita sandwiches filled with grilled chicken or spiced beef. In France, it sells Croque McDo sandwiches with melted cheese and ham. In India, it sells vegetarian McAloo Tikki burgers. In Mexico, it sells McMolletes sandwiches made with refried beans and cheese.

Being a global business also helps McDonald's weather the economic ups and downs of different regions. At one point during the recent recession, its Asian revenue grew almost twice as quickly as its European revenue, both of

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which balanced the smaller increase in U.S. sales. Worldwide, McDonald's owns some of its restaurants and also sells franchise licenses to firms that open restaurants under the McDonald's brand name. In some markets, the company operates restaurants in joint ventures with local firms. For example, in India, it has one joint venture with a local firm to operate restaurants in the west and south and a second joint venture with a different company to operate restaurants in the east and the north.

The company is also building its global business by attracting more customers during different "dayparts," such as at breakfast time and in the late-night hours. A growing number of its global units stay open 24 hours a day for customer convenience. McDonald's has introduced a steady stream of breakfast, beverage, snack, and sandwich items to encourage repeat visits from customers at all income levels.

On the high end, McDonald's is doing well with its McCafés, which serve mochas and other gourmet coffees in a separate area of selected McDonald's units. As the company opens new restaurants and remodels existing restaurants, it is adding more McCafés in U.S. and European markets. The Angus Burger is another popular premium menu item. Both McCafé coffees and Angus Burgers appeal to customers willing to pay a little more to splurge on high quality. At the same time, the items on McDonald's budget menus are priced to appeal to customers who keep a close rein on their wallets.

Being a major power in global business means McDonald's must think carefully about the value of the different currencies its restaurants take in. Outside the United States, much of its revenue is rung up in euros, British pounds, Australian dollars, and Canadian dollars. As a result, McDonald's pays close attention to swings in foreign-exchange rates as it manages its financial affairs.

McDonald's is stepping up its involvement in sustainability all around the world. It has increased its use of packaging made from renewable materials and boosted recycling efforts to keep waste out of landfills. It has also been building eco-friendly restaurants in North and South America as well as in Europe to test green construction methods and cut back on energy and water usage. The company's social responsibility menu includes supporting the Ronald McDonald House charities and offering a range of organic foods and beverages plus healthy snack choices.

From India to Ireland, Argentina to Australia, McDonald's is poised for continued growth in sales and profits as it expands its restaurant empire and cooks up new products for customers to enjoy around the clock and around the world.[13]

Questions

1. What are the advantages and disadvantages of McDonald's ringing up sales in so many foreign currencies worldwide?
2. Why would McDonald's use two joint ventures to operate restaurants in different regions of India?
3. Discuss how being a multinational enterprise, with a presence in more than 170 countries, helps McDonald's build its business regardless of the short-term global economic outlook.

Building Skills for Career Success

1 JOURNALING FOR SUCCESS

Discovery statement: This chapter was designed to excite you about international business and how trade among nations affects our daily lives.

Assignment

1. Assume that your friend, who recently lost his job in the automobile industry, is critical of imported Toyotas, Hondas, and Volkswagens. How would you respond to his resentment of imported goods?
2. What specific reasons will you offer to your friend in support of the fact that international trade is beneficial to society as a whole?
3. Ask your friend what might be some consequences if the trade among nations was banned.

2 EXPLORING THE INTERNET

A popular question debated among firms actively involved on the Internet is whether there exists a truly global Internet-based customer, irrespective of any individual culture, linguistic, or nationality issues. Does this Internet-based universal customer see the Internet and products sold there in pretty much the same way? If so, then one model might fit all customers. For example, although Yahoo.com translates its Web pages so that they are understood around the world, the pages look pretty much the same regardless of which international site you use. Is this good strategy, or should the sites reflect local customers differently? Visit the text Web site for updates to this exercise.

Assignment

1. Examine a Web site such as Yahoo! (http://www.yahoo.com) and its various international versions that operate in other languages around the world. Compare their similarities and differences as best you can, even if you do not understand the individual languages.
2. After making your comparison, do you now agree that there are indeed universal Internet products and customers? Explain your decision.

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3 DEVELOPING CRITICAL-THINKING SKILLS

Suppose that you own and operate an electronics firm that manufactures transistors and integrated circuits. As foreign competitors enter the market and undercut your prices, you realize that your high labor costs are hindering your ability to compete. You are concerned about what to do and are open for suggestions. Recently, you have been trying to decide whether to move your plant to Mexico, where labor is cheaper.

Assignment

1. Questions you should consider in making this decision include the following:
   a. Would you be better off to build a new plant in Mexico or to buy an existing building?
   b. If you could find a Mexican electronics firm similar to yours, would it be wiser to try to buy it than to start your own operation?
   c. What are the risks involved in directly investing in your own facility in a foreign country?
   d. If you did decide to move your plant to Mexico, how would you go about it? Are there any government agencies that might offer you advice?
2. Prepare a two-page summary of your answers to these questions.

4 BUILDING TEAM SKILLS

The North American Free Trade Agreement among the United States, Mexico, and Canada went into effect on January 1, 1994. It has made a difference in trade among the countries and has affected the lives of many people.

Assignment

1. Working in teams and using the resources of your library, investigate NAFTA. Answer the following questions:
   a. What are NAFTA's objectives?
   b. What are its benefits?
   c. What impact has NAFTA had on trade, jobs, and travel?
   d. Some Americans were opposed to the implementation of NAFTA. What were their objections? Have any of these objections been justified?
   e. Has NAFTA influenced your life? How?
2. Summarize your answers in a written report. Your team also should be prepared to give a class presentation.

5 RESEARCHING DIFFERENT CAREERS

Today, firms around the world need employees with special skills. In some countries, such employees are not always available, and firms then must search abroad for qualified applicants. One way they can do this is through global workforce databases. As business and trade operations continue to grow globally, you may one day find yourself working in a foreign country, perhaps for an American company doing business there or for a foreign company. In what foreign country would you like to work? What problems might you face?

Assignment

1. Choose a country in which you might like to work.
2. Research the country. The National Trade Data Bank is a good place to start. Find answers to the following questions:
   a. What language is spoken in this country? Are you proficient in it? What would you need to do if you are not proficient?
   b. What are the economic, social, and legal systems like in this nation?
   c. What is its history?
   d. What are its culture and social traditions like? How might they affect your work or your living arrangements?
3. Describe what you have found out about this country in a written report. Include an assessment of whether you would want to work there and the problems you might face if you did.

Running a Business PART 1

Graeter's

Let's Go Get a Graeter's!

Only a tiny fraction of family-owned businesses are still viable four generations after their founding, but happily for lovers of premium-quality ice cream, Graeter's is one of them.

Graeter's, now a $20 million firm, was founded in Cincinnati in 1870 by a young couple named Charlie and Regina Graeter, who made ice cream and chocolate candies in the back room of their shop, sold them in the front room, and lived upstairs. Refrigeration was unknown at the time, and ice cream was a novelty. Regina carried on the business for more than 30 years after her husband's death, at a time when women didn't run companies, opening not only a factory but also 20 additional stores. Her sons followed her into the firm, and three of her great-grandsons now share the responsibility for continuing to bring the company's original dense and creamy ice cream recipe to an ever-growing customer base.

The company currently operates a few dozen stores in Cincinnati and several neighboring cities, and its products are also available in hundreds of supermarkets thanks to

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distribution through big supermarket chains like Kroger's. Graeter's is currently building an additional factory to support its continued expansion, and it even operates a retail Web site where customers can order ice cream shipped anywhere in the continental United States, via UPS, guaranteed frozen on arrival.

SIMPLE SECRETS OF SUCCESS

Several factors make Graeter's unique and account for its long success. Perhaps the most important is product quality. Throughout its history, Graeter's has focused on using a unique manufacturing process that produces its signature ice cream flavors in small batches of about two gallons every 20 minutes. "Our competition is making thousands and thousands of gallons a day," says Chip Graeter, the company's vice president of retail stores. "We are making hundreds of gallons a day at the most. All of our ice cream is packed by hand, so it's a very laborious process." Graeter's "French pot" manufacturing method ensures that very little air gets into the product, producing the same creamy texture all ice cream used to have but few other brands can still achieve. The product is so dense that each pint of Graeter's weighs nearly a pound.

Another success factor is the use of simple, fresh ingredients. Fresh eggs, high-grade chocolate, pure cane sugar, and the choicest raspberries, strawberries, and other fruits in season are among the basic ingredients, and the company gets its milk and cream only from local farmers who guarantee their cows are not fed artificial growth hormones. (These hormones are believed to have environmental effects and health effects on humans.) "We use a really great grade of chocolate," says Bob Graeter, vice president of manufacturing. "We don't cut corners on that. . . . Specially selected great black raspberries, strawberries, blueberries, cherries, go into our ice cream because we feel that we want to provide flavor not from artificial or unnatural ingredients but from really quality ripe rich fruits."

WELCOMING CHANGE

Finally, while many things about Graeter's—like its recipes—have stayed simple, its recent expansion and future growth plans have resulted from something quite new to the firm: outside advice. The current generation of owners hired management consultants to help them achieve the kind of productivity increases that allowed for greatly increased capacity so that when Kroger's, for instance, suggested expanding Graeter's to a chain of supermarkets Kroger owns in Denver, the company could quickly ramp up production to fill the increased orders.

In recent years, change has come quickly to this small firm, which prospered for three prior generations by staying essentially the same. But, says Bob Graeter, success does require balancing consistency—what he calls "preserving the core"—with innovation. "If you just preserve the core," he says, "ultimately you stagnate. And if you are constantly stimulating progress and looking for new ideas, well, then you risk losing what was important. . . . Part of your secret to long-term success is knowing what your core is and holding to that. Once you know what you're really all about and what is most important to you, you can change everything else." One of those "important" things is giving back to the community and its families via local charities and other initiatives. Graeter's recently celebrated a new store opening by making a cash donation to the local public library, for instance, and has given a research foundation for pediatric brain cancer the proceeds from sales of a limited-time flavor created by the winner of a special drawing created for the purpose.

DEFINING THE COMPETITIVE LANDSCAPE

The company recognizes that while it produces a premium product in the ice cream category, its competition includes offerings other than ice cream. "We would be compared to Ben & Jerry's and Haagen Dazs," says Bob Graeter. "From a sales standpoint and from a shelf-space allocation, that is how [supermarkets] rank us, but . . . in my opinion that is really not our competition. Our competition is the upscale treats. It's like New York Cheesecake. That is our competition in my opinion. What is it that you are going to have when you want that indulgence, when you are willing to spend a thousand calories on dessert? It's going to be something that is fabulous. Graeter's in Cincinnati is synonymous with ice cream. People will say, 'Let's go get a Graeter's.' They don't say, 'Let's go get an ice cream.'"[14]

Questions

1. Think about the elements of Graeter's business that have stayed the same over its long history and those that have changed. Do you think the company's owners have chosen the right factors to change over time? Why or why not?
2. Which view of social responsibility does Graeter's management appear to take—the economic view or the socioeconomic view? What evidence in the case supports your answer?
3. Do you agree with Bob Graeter about what the company's real competition is? Why or why not?

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To access the online *Interactive Business Plan,* go to www.cengagebrain.com.

A *business plan* is a carefully constructed guide for a person starting a business. The purpose of a well-prepared business plan is to show how practical and attainable the entrepreneur's goals are. It also serves as a concise document that potential investors can examine to see if they would like to invest or assist in financing a new venture. A business plan should include the following 12 components:

- Introduction
- Executive summary
- Benefits to the community
- Company and industry
- Management team
- Manufacturing and operations plan
- Labor force
- Marketing plan
- Financial plan
- Exit strategy
- Critical risks and assumptions
- Appendix

A brief description of each of these sections is provided in Chapter 5 (see also Table 5.4 on page 148).

This is the first of seven exercises that appear at the ends of each of the seven major parts in this textbook. The goal of these exercises is to help you work through the preceding components to create your own business plan. For example, in the exercise for this part, you will make decisions and complete the research that will help you to develop the introduction for your business plan and the benefits to the community that your business will provide. In the exercises for Parts 2 through 7, you will add more components to your plan and eventually build a plan that actually could be used to start a business. The flowchart shown in Figure 3.6 gives an overview of the steps you will be taking to prepare your business plan.

THE FIRST STEP: CHOOSING YOUR BUSINESS

One of the first steps for starting your own business is to decide what type of business you want to start. Take some time to think about this decision. Before proceeding, answer the following questions:

- Why did you choose this type of business?
- Why do you think this business will be successful?
- Would you enjoy owning and operating this type of business?

Warning: Do not rush this step. This step often requires much thought, but it is well worth the time and effort. As an added bonus, you are more likely to develop a quality business plan if you really want to open this type of business.

Now that you have decided on a specific type of business, it is time to begin the planning process. The goal for this part is to complete the introduction and benefits-to-the-community components of your business plan.

Before you begin, it is important to note that the business plan is not a document that is written and then set aside. It is a living document that an entrepreneur should refer to continuously in order to ensure that plans are being carried through appropriately. As the entrepreneur begins to execute the plan, he or she should monitor the business environment continuously and make changes to the plan to address any challenges or opportunities that were not foreseen originally.

Throughout this course, you will, of course, be building your knowledge about business. Therefore, it will be appropriate for you to continually revisit parts of the plan that you have already written in order to refine them based on your more comprehensive knowledge. You will find that writing your plan is not a simple matter of starting at the beginning and moving chronologically through to the end. Instead, you probably will find yourself jumping around the various components, making refinements as you go. In fact, the second component—the executive summary—should be written last, but because of its comprehensive nature and its importance to potential investors, it appears after the introduction in the final business plan. By the end of this course, you should be able to put the finishing touches on your plan, making sure that all the parts create a comprehensive and sound whole so that you can present it for evaluation.

THE INTRODUCTION COMPONENT

1.1. Start with the cover page. Provide the business name, street address, telephone number, Web address (if any), name(s) of owner(s) of the business, and the date the plan is issued.

1.2. Next, provide background information on the company and include the general nature of the business: retailing, manufacturing, or service; what your product or service is; what is unique about it; and why you believe that your business will be successful.

1.3. Then include a summary statement of the business's financial needs, if any. You probably will need to revise your financial needs summary after you complete a detailed financial plan later in Part 6.

1.4. Finally, include a statement of confidentiality to keep important information away from potential competitors.

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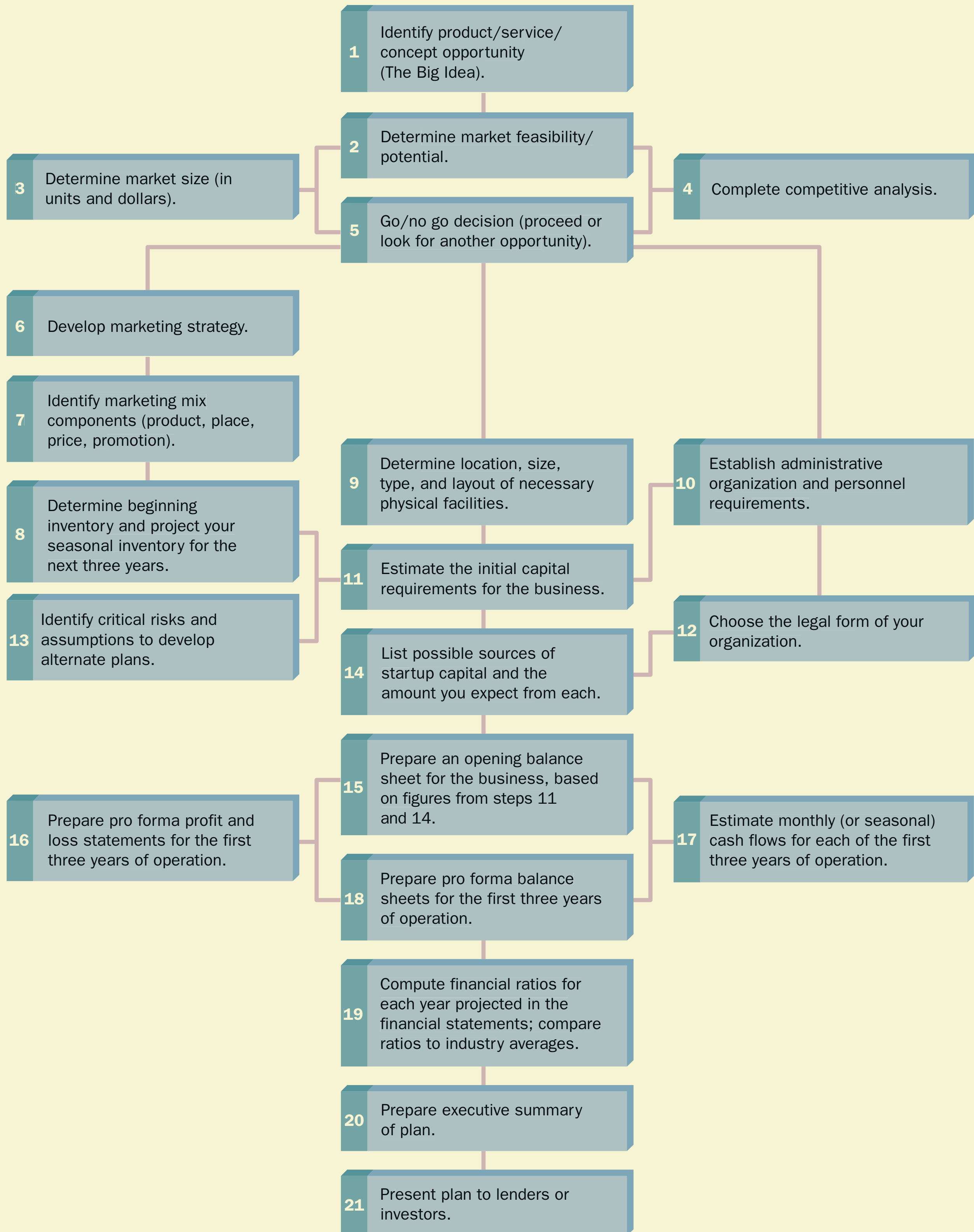
Figure 3.6 Business Plan



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THE BENEFITS-TO-THE-COMMUNITY COMPONENT

In this section, describe the potential benefits to the community that your business could provide. Chapter 2 in your textbook, "Being Ethical and Socially Responsible," can help you in answering some of these questions. At the very least, address the following issues:

1.5. Describe the number of skilled and nonskilled jobs the business will create, and indicate how purchases of supplies and other materials can help local businesses.

1.6. Next, describe how providing needed goods or services will improve the community and its standard of living.

1.7. Finally, state how your business can develop new technical, management, or leadership skills; offer attractive wages; and provide other types of individual growth.

REVIEW OF BUSINESS PLAN ACTIVITIES

Read over the information that you have gathered. Because the Building a Business Plan exercises at the end of Parts 2 through 7 are built on the work you do in Part 1, make sure that any weaknesses or problem areas are resolved before continuing. Finally, write a brief statement that summarizes all the information for this part of the business plan.

The information contained in "Building a Business Plan" will also assist you in completing the online *Interactive Business Plan*.

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