

Environment of International Business and its Significance

Dr. Akram Abdulraqeb Sultan Al-Khaled
Ernst & Young Advisory Services, Kuala Lumpur, Malaysia

DOI Link: <http://dx.doi.org/10.6007/IJARBSS/v7-i3/1644>

Published Date: 30 March 2017

Abstract

The simple observation that a market exchange process frequently generates significant transactions costs for the participants is not of itself, however, decisive in determining the form of alternative arrangement that would provide the most effective substitute to the price mechanism. Historians are only too aware that, in practice, a wide variety of institutional arrangements have been adopted by different societies in order to organize their economic activities.

Academic quest to keep up with the rapid pace of globalization in business and industry. Clearly, the nature of doctoral research provides an indication of the quality and emerging direction of research in IB. It is not surprising that the Academy of International Business started a best dissertation award in 1986 that selects four finalists and a winner each year (renamed the Farmer Award in 1990). These Farmer Award finalist dissertations represent some of the best scholarly thinking in international business. Their selection as finalists reflects the judgments of the Farmer Award committees consisting of senior IB scholars and based on criteria established by the Academy of International

Introduction

One of the most dramatic and significant world trends in the past two decades has been the rapid, sustained growth of international business. Markets have become truly global for most goods, many services, and especially for financial instruments of all types. World product trade has expanded by more than 6 percent a year since 1950, which is more than 50 percent faster than growth of output the most dramatic increase in globalization, has occurred in financial markets. In the global forex markets, billions of dollars are transacted each day, of which more than 90 percent represent financial transactions unrelated to trade or investment. Much of this activity takes place in the so-called Euromarkets, markets outside the country whose currency is used.

This pervasive growth in market interpenetration makes it increasingly difficult for any country to avoid substantial external impacts on its economy. In particular massive capital flows can push exchange rates away from levels that accurately reflect competitive

relationships among nations if national economic policies or performances diverse in short run. The rapid dissemination rate of new technologies speeds the pace at which countries must adjust to external events. Smaller, more open countries, long ago gave up illusion of domestic policy autonomy.

Structure of Porter's 5 Forces Analysis



- The competitive rivalry within the industry the competition between firms determines the attractiveness of a sector. Companies are struggling to maintain their power. The competition changes based on sector development, diversity and the existence of barriers to enter. In addition it is an analysis of the number of competitors, products, brands, strengths and weaknesses, strategies and market share
- The threat of new entrants it is in a company's interest to create barriers to prevent its competitors to enter to market. They are either new companies, or companies which intend to diversify. This barriers can be legal (patent regulations...), or industrial (products or single brands,).The arrival of new entrants also depends on the size of the market (economy of scale), the reputation of a company already installed, the cost of entry, access to raw materials, technical standards, cultural barriers,....
- The threat of substitute products the substitute products can be considered as an alternative compared to supply on the market. These products are due to changes in the state of technology or to the innovation. The companies see their products be replaced by different products. These products often have a better price/quality report and come from sectors with higher profits. These substitute products can be dangerous and the company should anticipate to cope with this threat.
- The bargaining power of suppliers the bargaining power of suppliers is very important in a market. Powerful suppliers can impose their conditions in terms of price, quality and quantity. On the other hand if there are a lot of suppliers their influence is weaker. One has to analyze the number of realized orders, the cost of changing the supplier, the presence of raw materials,
- The bargaining power of customers if the bargaining power of customers is high, they influence the profitability of the market by imposing their requirements in terms of price, service, and quality. Choosing clients is crucial because a firm should avoid to be in a situation of dependence. The level of concentration of customers gives them more or less power. Generally their bargaining power tends to be inversely proportional to that of the suppliers

The significance of International Business

➤ To Expand Sales

The first and foremost reason is that western multinationals would like to expand their sales and acquire newer markets so that they can record impressive growth rates. Considering the fact that the developing countries are peopled with consumers who have aspirations to western lifestyles, it is, but natural that the western companies would like to target this need and hence, expand into these markets. Moreover, with declining sales in one region, the western companies hope to recoup the losses by expanding into other markets. Further, the attractive rates of return in the emerging markets are another reason as well.

➤ Acquire Resources

This is one of the most important reasons for companies to expand internationally. Because the developing and emerging countries have large deposits of minerals, metals and land for agricultural production, the western multinationals eye these markets in order to get access to the resources. This is the reason why many international businesses operate in Africa and South Asia where the humungous deposits of minerals and metals are attractive for the profits that these multinationals can make. Many emerging markets and developing countries do not have the expertise or the resources needed to tap their reserves of these minerals and metals. Hence, they welcome the multinationals with open arms as it gives them royalties and other payments to grow their economies. As can be seen from the expansion of Vedanta and the South Korean steel company (POSCO) into India, the eagerness to tap the resources is one of the most important reasons for expansion.

➤ Minimize Risk

Often, businesses expand internationally to offset the risk of stagnating growth in their home country as well as in other countries where they are operating. For instance, ever since the Western countries saw their growth rates slip to below 3% (in cases recording negative growth i.e. depression), the Western multinationals have made a beeline to the emerging markets that are growing in excess of 5%. Since firms exist to make profits and grow their bottom lines, it is but natural for them to expand internationally into countries that have better growth rates than their home country. Further, by operating in a basket of countries as opposed to a few, they are able to manage political, economic, and societal risks better. We have discussed the characteristics of these risks in earlier articles. Because they vary from country to country, it makes sense to spread risk across countries and diversify the portfolio rather than placing all eggs in one basket.

Closing Thoughts

Though this article has concentrated on western companies alone, it is the fact that many Chinese companies are aggressively expanding into African and Asian markets. In the same way in which Japanese companies conquered Western markets with superior quality, low cost, and exemplary customer service, the Chinese companies hope to target the emerging and developed markets with the same vigor and passion that has made China the factory of the world. These themes would be explored in detail in subsequent articles and this article has given the bare bones reasons why businesses expand internationally.

International business is not a new phenomenon but has been practiced around the world for thousands of years. Through the routes established in the Mediterranean, the Phoenicians, Mesopotamians, and Greeks did trading. As sophisticated business techniques emerged, facilitating the flow of goods, resources and funds between countries flourished. This growth

was further stimulated by colonization activities. The Industrial Revolution further stimulated the growth of international business by providing methods of production for mass, markets and efficient methods for utilizing raw materials. The inventions and technological developments from Industrial revolution further accelerated the smooth flow of goods, services and capital between the countries. The production grew at unprecedented levels by 1880's as the industrial revolution was in full swing in Europe and the United States. Growth continued in an upward spiral as mass production was realized and the manufactures were pushed to seek foreign markets for their products. This marked the emergence of multinational corporations. (Ajami, Cool, Goddard and Khambata, 2006)

APPROACHES AND METHODS OF ENGAGEMENT

1. Exporting
2. Turnkey projects
3. Licensing
4. Franchising
5. Joint Ventures
6. Foreign Direct Investments (FDI)

Exporting is the where the firm manufacture the products locally and ship those goods to the foreign country. This is a commonly used strategy by small to medium business organizations. Exporting has many advantages such as:

- Startup cost involved in establishing production plants abroad is avoided and firm can use the local manufacturing bases to produce goods.
- When the production is done in mass scale for facilitate exports worldwide it will result in experience curve effect where the cost of production per unit will decrease.
- Location advantages of the home country such as low labor costs and tax reliefs can be utilized.

Exporting has many disadvantages such as:

- Exporters have to compete with the low cost local manufacturers in the foreign country. High transportation cost is involved.
- Barrier to trade such as tariff and non-tariff barriers exists and it reduces the competitiveness of exports.
- Exporters have to obtain the service of marketing representatives in the foreign markets and exporter does not have control over those marketing representative.

Turnkey Projects Turnkey projects are foreign projects that are undertaken by local contractors. Local contractor agrees to perform all the tasks of the project for the foreign client for the fee paid. Turnkey projects are mostly carried out in disciplines such as IT and engineering. Turnkey projects has many advantages such as:

- Local contractor can earn fee on the specialized knowledge he possesses.
- There is a less risk involved as the company doesn't start manufacturing plants overseas.

Turnkey projects has many disadvantages such as:

- After the project is completed firm loses the interest in the foreign country and there will be no long term foreign operations.
- When the knowledge is sold to a foreign country that is similar to selling the competitive advantages that are possessed by the locals.

Licensing

Licensing is an agreement by which a licensor grants the right to another firm use an intangible property for a specified time period for a royalty payment in return. Licensing agreement will specify the scope of the contract, compensation for the breach of agreement, rights and responsibilities of parties and the duration of the contract.

Licensing has many advantages such as:

-Low financial risk for both parties as they are not making huge investment when compared to FDI.

-Barriers to trade such as tariff and non-tariff barriers are avoided as there is no import or export involved.

-Local markets can acquire knowledge from foreign markets with less effort and less cost.

Licensing has many disadvantages such as:

-Both parties will make less profit due to terms of the contract.

-Creates a situation that licensee has to purely depend on the licensor to obtain knowledge and it limits the scope.

-Conflicts may arise between parties.

-Upon the completion of the contract there is a potential threat that licensee coming up with similar product/resource with the knowledge gained from license.

Franchising

Franchising is an agreement by which franchisers sells an intangible asset such as a brand name to the franchisee and impose rules on how to conduct the business. Franchisee has to pay a royalty payment to the franchiser in return.

Franchising has many advantages such as:

-Low financial risk for both parties as they are not making huge investment when compared to FDI.

-Barriers to trade such as tariff and non tariff barriers are avoided as there is no import or export involved.

-Local markets can acquire knowledge from foreign markets with less effort and less cost.

-Franchiser gets access to local market with a lessor cost without establishing manufacturing plants at their cost.

-Franchiser gets more control over operations of franchisee and business standards of franchiser can be expected locally. Franchising has many disadvantages such as:

- Both parties will make less profit due to the terms of the contract.
- Creates a situation that franchisee has to purely depend on the franchiser to obtain knowledge and it limits the scope.
- Conflicts may arise between parties.
- Upon the completion of the contract there is a potential threat that franchisee coming up with a similar product/resource with the knowledge gained from franchising.
- Foreign capital inflow and outflows stopped.

Joint Ventures

Joint Ventures is a situation where a foreign firm enter into an agreement with a local firm to conduct business as one entity. Both parties may contribute to the business in many ways such as capital, skills, management, knowledge and brand name.

Joint Ventures has many advantages such as:

- Sharing of costs, benefits and risks among partners.
- Benefits from the local partner's knowledge about local market.
- Since there are local firms involved government will support the growth of the venture.

Joint Ventures has many disadvantages such as:

- Parties may get into conflicts.
- Deadlock managements can exist.
- Sharing technology gives rise to a risk of unethical use of technology by local firms.

Foreign Direct Investment (FDI) is a strategy where the firm directly sets up a manufacturing plant or business operation in a foreign country as a fully owned subsidiary of the parent company. Level of FDI is identified as an indicator of economic growth as it directly links with the GDP level of an economy.

FDI has many advantages such as:

- Company can earn high profits as no middlemen involved.
- Heavy control over foreign operations can be maintained as firm directly runs the business.
- Knowledge about local markets can be improved as the proximity to the customer increases.

-Barriers to trade such as tariff and non tariff barriers are removed.

-Facilitate growth of an organization.

FDI has following disadvantages:

- FDI involves heavy investment and company has to find ways to finance the investment.
- Exposes company to the political risk of the host country as FDIs are highly regulated by host country governments.
- Operations gets complicated as the parent company has to manage a subsidiary which is based on a foreign country with different political, economic, social and technological environment.

Conclusion

International business overall it is best when conducted effectively and efficiently. Considering all the necessary steps that have to be followed while practicing international business. Advantages are of both sides whether you export or import what matters the most is how your products are accepted in the market within and outside the country. However challenges are not predictable nor definite when it comes to failure in the market. All a company can do is give out its best and make sure goals are achieved at last. Changes are visible now as markets have seen the development that has taken place in international business.

List of References

- 1) Subhash C Jain, International Marketing, Thompson Learning, Singapore
- 2) Ricks, D, A. 1992/1993. The field of international business and JIBS' role in it. Journal of Business Administration 21 (1, 2).
- 3) Scherer, R. F., and Sarah T. B. (2002). Internationalizing the business curriculum. Cleveland, OH: Lakeshore Communications

- 4) Thanopoulos, J., and Ivan, R. V. (1987). International business education in the AACSB schools. *Journal of International Business Studies* 18 (1, Spring/Summer): 91–9
- 5) Buckley, P. J. (2004). *The Challenge of International Business*. New York: Palgrave-MacMillan.
- 6) Zhang, Tingqin and Zhou, Hui. (2008). The significance of Cross-cultural Communication in International business Negotiation. *International Journal of Business Management*. Vol. 3(2), 103 –109
- 7) Ghose, S. & Lowengart, O. (Sep, 2001) “Perceptual positioning of international, national and private brands in a growing international market: An empirical study” *Journal of Brand Management*.