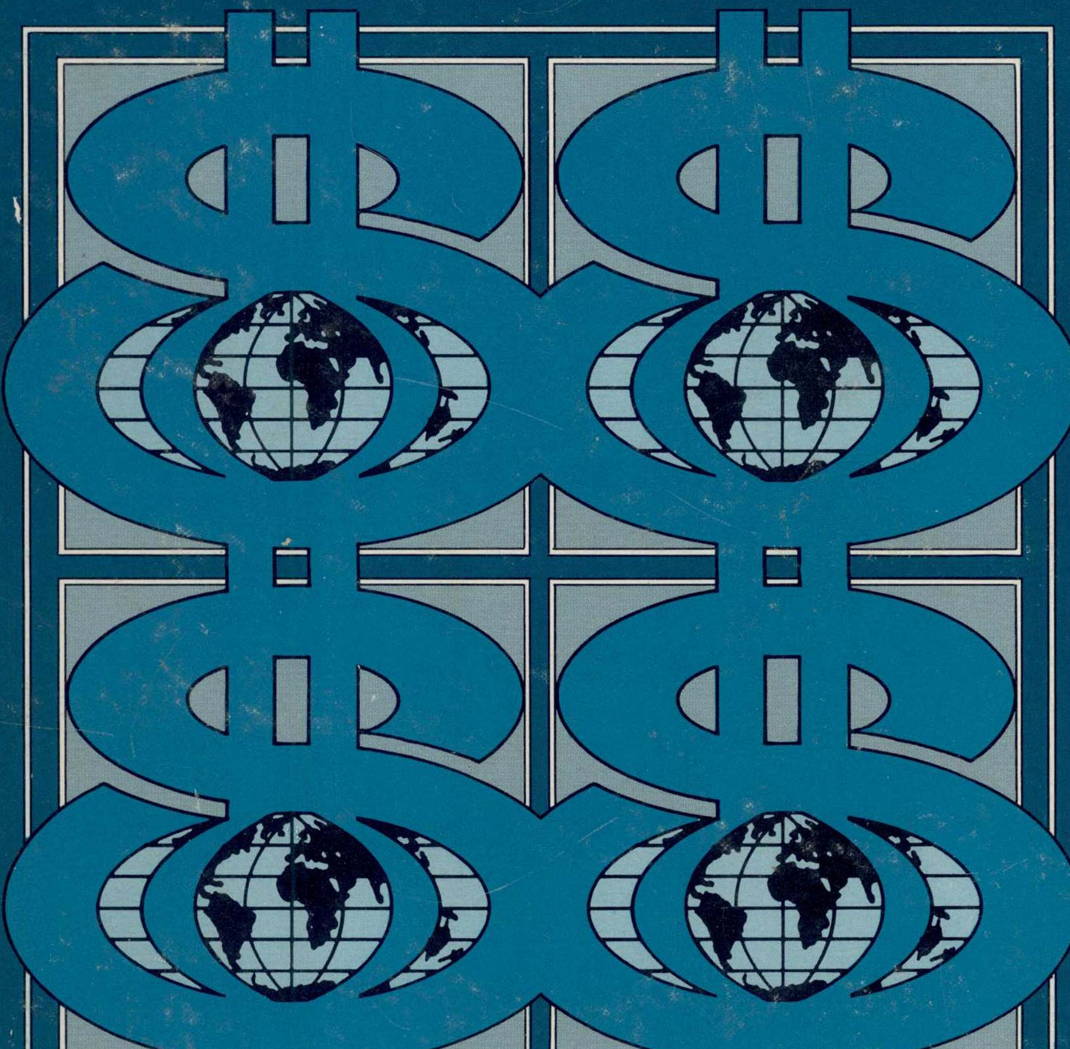
# International Business

## Environments and Operations

THIRD EDITION



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*THIRD EDITION*

# INTERNATIONAL BUSINESS: ENVIRONMENTS AND OPERATIONS

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# Preface

What should be taught in a first course in international business when some of the students will thereafter have little or no direct classroom exposure to the subject and others will use this first course as background for more specialized studies in the area? This is the major question that guided us in the development of each of the three editions of this textbook.

The growth of international business in its many forms and the resultant concern of business, government, and society as to how best to deal with this phenomenon have received so much publicity that it would be redundant to explain in great detail the need for understanding international business environments and operations. It is important, however, to explain why we selected our particular approach to the subject.

Our observation is that a growing number of students are being exposed to some type of survey, overview, or introductory course in international business. Since the field lacks a basic underlying theory of its own and instead relies on the interplay between the social sciences and all the functional areas of business, we feel that a broad approach emphasizing these complex interrelationships is essential from the start. Otherwise, there is the danger that a student will either not understand the connection between diverse international environments and the conduct of business or will assume that a single environmental factor (e.g., economics, politics, or culture) is the cause for all business nuances internationally.

From the beginning, therefore, we agreed to present the subject from both an environmental and an operational perspective, covering a substantial breadth of topics within each context. Beyond this, the choice of topics and decisions on depth of coverage became more cumbersome. We wanted, for example, to expose the student to theories—e.g., trade—and to some of the functional adjustments—e.g., marketing—but realized that there was no way to cover any of the topics as extensively as if an entire course or text were devoted to the subject. The biggest problem for the first and for the subsequent two editions was in deciding what to cut. There was a tendency to want to include everything and give in-depth analyses, but that was, of course, impossible. The text could not then be completed in one term, and it would duplicate rather than complement those used in such specialized courses as international finance, comparative management, and international trade.

Although we were gratified that the first two editions were so well received, we were convinced that we should do much more than up-date figures for the third. To begin with, the international business field has evolved and matured a great deal in the past three years; thus the newer topics, concerns, and research should be incorporated. We also felt we could make substantial improvements in organization and clarity. We have been fortunate from the start of the first edition to have had colleagues who would take the effort to critique draft materials, react to coverage already in print, and advise on suggested changes. There has naturally not been a consensus; however, we have gotten enough agreement to be satisfied on how to proceed. Many more individuals than we can possibly list have helped. Nevertheless, we are particularly indebted to Professor Phillip D. Grub, George Washington University; William R. Hoskins, Bowling Green State University; Edward M. Mazze, Temple University; Lee C. Nehrt, Ohio State University; Robert L. Thornton, Miami University; Robert Grosse and Duane Kujawa, University of Miami; J. J. Boddewyn, Baruch College, CUNY; Ralph Gaedeke, California State University, Sacramento; Richard M. Moxon, University of Washington; Arnold Stebinger, University of South Carolina; Thomas Bates, San Francisco State College; Umesh C. Gulati, East Carolina College; William A. Stoever, Rutgers University; Arvind K. Jain, McGill University; Michael J. Hand, Georgetown University; Craig Woodruff, American Graduate School of International Management; and George Sutija, Florida International.

For this edition we have continued some of the objectives we set earlier regarding method of presentation. These included the use of ample real-world examples, *coverage from a worldwide rather than just a U.S. standpoint, the application of* studies and theories from social science and functional disciplines not heretofore presented as explanations of international business, discussions of the diverse approaches taken by business and governments in similar environmental or operational situations, and an inclusion of sufficient annotated references to enable readers to easily find additional information on topics.

A major change in the method of presentation has been to add short cases to most chapters. Those used at the beginning of chapters are designed to introduce much of the material to follow. Those at the end of chapters are designed for discussion once the text of the chapter has been covered. To the extent that we succeeded in these respects, the student should develop an appreciation of the relevance and complex interdependencies of cross-national commercial relationships.

We have maintained the basic order of presentation of the second edition but have tried to make the chapters sufficiently independent so that professors can alter the order of presentation to fit their own needs. Because of differences in the materials covered, the number of chapters included in each major section varies. The materials in the basic sections and the order of presentation are: (1) an overview of current business patterns and their historical antecedents; (2) the social systems within countries as they affect the conduct of business from one country to another; (3) the major theories explaining international business transactions and the institutions influencing the activities; (4) the financial forms and institutions that measure and facilitate international transactions; (5) the interface between nation-states and the firms attempting to conduct foreign business activities; (6) the alternatives for overall corporate policy and strategy that accommodate global operations; (7) the concerns and management of international activities that fall largely within functional disciplines; and (8) the variety of alternative ways in which international business may evolve in the future.

Among the changes in this edition are the greater emphasis on export activities and the greater differentiation of practices for firms fairly new to international operations from those with already heavy commitments. One of the means to achieve the former has been to devote a new chapter, Chapter 15, to trade and logistics matters. The materials on research formerly in that chapter are now incorporated as parts of Chapters 17, 18, and 19. Policies concerning commitment differences are included throughout.

Inevitably the question arises as to the intended level of readership. We have aimed the book at upper-level undergraduate students. We feel the text may serve also for similar survey courses at the graduate level but caution that if used there it should be supplemented with outside readings.

We three coauthors come from diverse functional backgrounds and, furthermore, represent a gamut of opinions on the proper role of business and government in international economic affairs. In order to develop better coherence among the chapters, we each read, criticized, and contributed to one another's sections. John D. Daniels was charged with Chapters 4, 6, 7, 12, 13, 14, 16, 17, 18, 19, 23, and 24; E. W. Ogram, Jr. with Chapters 1, 2, 5, 9, and 10; and Lee H. Radebaugh with Chapters 3, 8, 11, 15, 20, 21, and 22. Chapter 25 was a collaborative effort for us all. Several typists and graduate students were extremely helpful to us in the preparation of this edition, and without this anonymous support we could not have made the necessary changes. Some others were so helpful that we cannot let them remain anonymous. They are Maria Bardoutsou, Michael Jubb, Carlos Rojas, Ruby Shepherd, Janice Shields, Paul Jenner, Cheng Suan Ooi, Janice Clower, and Dorothy Hellman.

*March, 1982*

J.D.D.
E.W.O.
L.H.R.

# Contents

# PART 1
# BACKGROUND

*Whether we are managers actively engaged in decision making within an internationally competitive environment or citizens interested in regulating international businesses to achieve our own objectives, it is useful to know how today's pattern of global commerce has developed.*

*Chapter 1 defines the field and relates it to both the functional areas of business (i.e., marketing, finance, and management) and to the basic disciplines, such as geography, law, and economics. Within this frame of reference, international business can be viewed as a combination of basic disciplines and functional studies that focuses on the problems and opportunities presented when a company makes a commitment to sell or produce abroad. The chapter continues with an overview of the historical evolvement of business organizations and institutions, which helps explain why today's business is conducted as it is.*

*Chapter 2 examines recent trends in world trade and investment. The primary emphasis here is on geographic patterns and changes in product composition, as well as on the companies involved. By examining the patterns, the stage is set for succeeding chapters, which analyze why these patterns exist, why countries would like to alter them, and how international business is conducted within this scenario.*

*ONE*

# *International Business: An Overview*

- *To define the field of international business and emphasize the differences between business within the domestic and international contexts.*
- *To define and discuss briefly basic terms relevant to international business.*
- *To discuss the different means—such as exporting, licensing, and investing—a firm can use to accomplish its international objectives.*
- *To emphasize the critical importance of history in understanding current international business relations.*
- *To introduce and elaborate on the factors responsible for U. S. corporate movement abroad and for foreign companies' involvement in the U. S. market.*
- *To underline company differences insofar as they affect and are affected by environmental and operational constraints.*

## THE FIELD OF INTERNATIONAL BUSINESS

**International Business** International business involves either private or governmental business relationships conducted across national boundaries. In the case of private firms, these transactions are for profit. Government-sponsored activities in international business may or may not have a profit orientation.

Specific types of activity eligible for the term "international business" involve the private and public sectors in the buying and selling of goods; investing in industries, such as manufacturing, oil, public utilities, agriculture, business, and mining; the licensing of processes, patents, or trademarks; and supplying personal services, such as in the marketing, legal, financial, insurance, transportation, accounting, or management consulting areas. The field of international business, then, is a broader area of study than what economists traditionally refer to as the field of international trade. In the latter case, analysis is focused primarily on the flow of commodities among nations.

Inasmuch as international business operates within the broad context of the world environment, it must of necessity draw on the contribution of a number of basic disciplines, including geography, history, politics, law, economics, and culture. In addition, international business covers the functional business fields of marketing, management, and finance. These basic disciplines and functional areas play a significant role in the conduct of international business; consequently, a fundamental grasp of their importance is necessary if the manager is to function effectively in the international environment.

*Geography*, the first-named discipline, is important because it determines the location, quantity, and quality of the world's resources and their availability for exploitation. Geographical barriers, i.e., high mountains, vast deserts, or inhospitable jungles affect communications and channels of distribution for companies in much of the world's economy. The distribution of human life in various areas of the world and the impact of human activity on the environment is critical in determining the nature of international business relationships.

*History* provides us with a systematic recording of the evaluation of ideas and institutions. Looking at the past gives us a clearer understanding of the functioning of international business activities at the present time. To illustrate the critical role history plays in international business, compare after reading the chapter the way a transaction might have taken place in ancient times to a similar transaction in today's jet age technology.

*Political Science*, the study of the processes, principles and organization of governments and political institutions, has played and will continue to play an important role in shaping the present and future thrust of international business throughout the world. It delineates the relationships between business and national political organizations and, in turn, helps to explain behavior patterns of governments and business firms in areas of potentially conflicting interests. For example, an international company with a subsidiary in country X wishes to close its subsidiary. The reason given is that country X's government has adopted policies that make it unprofitable for the company to keep the subsidiary. Country X's government, on the other hand, is committed to maintaining full employment. Thus, country X would look with much disfavor on any company closing its plant, thereby reducing employment in the country.

*Law,* both domestic and international, in large measure determines what the manager of an international company can or can't do when exporting, importing, investing, or consulting in the overseas market. This includes domestic laws in both the home and host countries that facilitate such matters as taxation, employment, and local content (the percentage of the total product that must be manufactured in the host country plant). About 90 percent of what an international company does is determined by custom. For example, the major trading nations in the world economy have long agreed that specific terms used in export pricing have a commonly accepted meaning. The remaining 10 percent of what an international firm can do is determined by multilateral and bilateral treaties.

*Economics* provides the analytical tools necessary for determining (1) the impact of an international company in the economy of the host and home countries and (2) the effect a country's economic policies have on the international company. Economic theory also explains why nations trade with each other and why companies choose to export their product or service rather than invest in an overseas plant. Such an investment can be classified as either direct or portfolio investment.

**Direct and Portfolio Investment** For direct investment to take place, control must follow the investment. This can amount to a small percentage of the equity of the company being acquired, perhaps even as low as 10 percent. Portfolio investment can be in either debt or equity, but the critical factor is that control does not follow this kind of investment.

*Culture* describes the values, attitudes, and beliefs people have concerning themselves and their environment. In large measure, insofar as business is concerned, culture helps to explain what is and what is not acceptable behavior in society.

Many areas of international business, especially marketing, are directly influenced by cultural influences. International marketing necessitates a closer relationship to local culture than finance and production. For example, the Campbell Soup Company invested $6 million in capital and $2 million in advertising the canned soups it introduced to the Brazilian market. Since the firm had noted brisk sales of dehydrated soups by competitors such as Knorr and Maggi, little was done in the way of advance market tests. After the expected canned soup sales did not materialize, a company-retained psychologist revealed through in-depth interviews in 1981 that housewives did not feel they were fulfilling their roles as homemakers if they could not call the soup their own. With dehydrated soup, they could add their own flair and ingredients.[1]

The disciplines of geography, history, political science, law, economics and culture each play a significant role in determining the type of environment that all firms in international business must deal with in attempting to sell their product or service in the overseas market. Much of the first half of the book will describe this international business environment, a given in that a firm involved in overseas operations must accept it as a factor over which the firm has no control.

The remaining chapters of the text look at international business from the point of view of the firm itself. Given a particular environment, the international company then must plan and carry out its marketing, financial, and management strategies as well as its accounting and labor policies in relation to the given environmental constraints.

International marketing embraces the many problems and decisions that must be made in promoting, pricing, and distributing a product or service in the international market. International finance considers financial variables such as exchange rates, balance of payments, and capital markets and their role in the planning and management process for direct investment in one or more of a number of country markets abroad. International management incorporates the subareas of organization, production control, and personnel. The problems of labor in international business include differences in compensation policies and practices and the impact of multinational operations on collective bargaining, as well as labor-market differences among nations. Accounting in international business involves the basic issues of translation of income and balance sheet statements and the protection of working capital. The field of international business, then, essentially combines many basic disciplines with functional studies of the problems and opportunities involved when a company makes the commitment to begin international operations.

Fig. 1.1 shows the relationship of environment, the basic disciplines, to operations, the functional areas of international business. Environmental variables are designated by circles on the diagram; operational variables are shown in rectangles. The arrows running from the environment to operations indicate that each of the functional areas is determined by the environment.

As an example of this relationship between environment and operations, consider a Western firm that wants to sell a product or service to one of the Eastern European countries, the USSR, or the People's Republic of China (PRC). The system of markets and prices in the West that determines whether or not the product or service will be sold is not applicable because markets determined by supply and demand do not exist in the USSR, PRC, or Eastern Europe. Environmental variables—the economic and political systems in these countries—dictate the type of marketing and financial strategy the Western firm must use if it hopes to sell its product or service in this market.

## INTERNATIONAL AND DOMESTIC BUSINESS COMPARED

International business is really a foreign extension of domestic business, but there are important differences. Both domestic and international transactions take place between individuals and corporations; that is, business involves sales from producers and intermediates to consumers. Also, in most cases profit is the driving force behind each transaction. In the free world it is the motive for the great majority of all domestic and international business transactions. The differences between